ASSESSING THE CALIFORNIA ENERGY CRISIS: HOW DID WE GET TO THIS POINT, AND WHERE DO WE GO FROM HERE?

JOINT HEARINGS

BEFORE THE

SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND REGULATORY AFFAIRS

AND THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

APRIL 10, 11 AND 12, 2001

Serial No. 107–28

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ASSESSING THE CALIFORNIA ENERGY CRISIS: HOW DID WE GET TO THIS POINT, AND WHERE DO WE GO FROM HERE?

TUESDAY, APRIL 10, 2001

HOUSE OF REPRESENTATIVES, ,
SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND REGULATORY AFFAIRS, ,
COMMITTEE ON GOVERNMENT REFORM, ,
Sacramento, CA.

The subcommittee met, pursuant to notice, at 11 a.m., in the Sacramento Convention Center, room 204, 1400 J Street, Sacramento, CA, Hon. Doug Ose (chairman of the subcommittee) presiding.

Present: Representatives Ose, Horn and Burton.

Staff present: Dan Skopec, staff director; Jonathan Tolman, professional staff member; Regina McAllister, clerk; and Elizabeth Mundinger, minority professional staff member.

Mr. OSE. Good morning. A quorum being present, the subcommittee will come to order. I ask unanimous consent that all Members' and witnesses' written opening statements be included in the record. Without objection, so ordered.

I ask unanimous consent that all articles, exhibits, and other material referred to be included in the record. Without objection, so ordered.

I ask unanimous consent that Members of Congress who are not members of the committee be allowed to participate in today's hearing. Without objection, that is agreed to.

I ask unanimous consent that all questions submitted in writing to the witnesses, and their answers, be included in the hearing record. And, I ask unanimous consent that questioning in this matter proceed under clause 2(J)2 of House rule 11 and committee rule 14 in which the chairman and ranking minority member allocate time to members of the committee as they deem appropriate for extended questioning, not to exceed 60 minutes equally divided between the majority and the minority. Within objection, so ordered.

I want to welcome everyone to the first of three hearings we will be holding on the California energy crisis. Judging by the turnout here today, I think we can safely say that this is a crisis that is on the mind of everyone in California and around the country. I am hopeful that these hearings will bring about an honest discussion of our problems, and produce some agreeable resolutions to this crisis. I especially want to thank Chairman Burton for allowing the committee the opportunity to conduct these hearings in California.

Although Chairman Burton is from Indiana, I think we will find that resolving California's energy crisis is vital to the economic well being of the entire country.

I also want to thank all of the other Members of Congress who made the journey to Sacramento, and, in particular, Chairman Horn from Long Beach. I look forward to your ideas and participation.

The availability, reliability, and price of power are an integral part of our economic and social success. The converse of that statement is also true: An unavailable, unreliable, and expensive source of power will cause an economic and social crisis. And, to be sure, this is a crisis.

Few public policy issues affect consumers as much as energy. Higher energy prices and the threat of blackouts affect all Californians. California consumers will be faced with higher energy prices that will cause real hardship to low income families and those living on fixed incomes. I am especially concerned about those who share a home with numerous extended family members. These families will be held to the same energy baseline use standards as a typical nuclear family, even though they could have two or three times as many people living under the same roof. Consumers will also pay more for products they purchase as businesses are forced to pass on higher energy costs to their consumers.

I am deeply concerned that seniors living on fixed incomes will have to choose between air conditioning or costly medicines in the summertime, or heating in the winter. Either choice could be deadly.

In addition, as a result of the crisis, consumers will pay more in the form of squandered surpluses, resulting in higher taxes and cuts in government programs, such as education, law enforcement, health care, and tax relief. And I just want to point out, the San Francisco Chronicle this morning had an article that listed the daily expenditures for anti-smoking, for an algebra education, and for the war on amphetamine on a comparative basis to what we are spending, unanticipatedly for power.

Businesses will also face increased costs as a result of this crisis. The cost of doing business in California is already very high relative to the surrounding States. I am fearful that high energy costs will drive more businesses out of California, because many of the small businesses here right now will be unable to pass on higher costs or relocate. The losses of good jobs and tax revenues because of the energy crisis are grave concerns for me. Intel Corp., for instance, has stated very clearly that it will no longer invest in California, citing an unfriendly business climate and uncertainty as to the supply of a reliable source of power.

Let us also not forget that the California agricultural industry is being devastated by high natural gas prices, and must brace for massive increases in its electricity bill. As you know, most farmers operate on very tight margins. They simply will not be able to absorb the price hikes in both natural gas and electricity.

Clearly, high energy prices will have a large, negative effect on the California economy, and could possibly drag the rest of the Nation into a recession. But, there is something even worse than high energy prices, and that is blackouts. Just last week, as reported by the L.A. Times, experts were predicting over 30 days of blackouts this summer, and where blackouts occur, disaster follows. Long-term blackouts this summer will endanger lives, especially for our seniors. We have already seen this happen in Chicago during the summer of 1998. People of fragile health, who live in the deserts and valleys of California, will be at extreme risk when the blackouts hit.

Blackouts wreak havoc on businesses as well. Tomato farmers in the Third Congressional District tell me that if a processing plant is shut down due to a blackout, that is, power is cutoff without any explanation or anticipation, they lose the entire product that is being processed, and then have to shut down for days to clean and sanitize the plant.

The same is true in Silicon Valley, where chipmakers could lose millions of dollars if they here hit with a single blackout. Another example, and we will hear more from Mr. Verboom later, is the dairy industry. If a dairy farmer is hit with a blackout, you cannot milk your cows. I do not know about you, but it is my understanding that if you do not milk a cow, you have a problem, especially if that cow is ready to be milked. These are but a few examples of a problem that will occur among many industries statewide when blackouts hit.

The purpose of this hearing is to seek input as to what role the Federal, State, and local governments have in creating a solution for this energy crisis. Some of the questions I hope to answer are: What measures have been taken by the State of California to solve this crisis? In the wake of PG&E's bankruptcy filing, does the Governor have a new plan? Has the Bush administration been responsive to requests from the State of California? What Federal regulatory measures can be taken to help ease the current crisis? And, finally, what is the prospect for a solution in the near term and in the long term?

I want to thank all the witnesses for coming today. I know it is tough to make time to testify. I am looking forward to hearing from every one, because they each have a unique perspective that is important to our discussion. I am hopeful that together we can shed some light on what Californians can expect this summer, and take some necessary steps to ensure that California's energy concerns are finally put behind us.

Now, I would like to recognize my colleague, Chairman Burton, for the purpose of his opening statement.

STATEMENT OF DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BURTON. It is nice to be in California. It sure is a beautiful day. And I am sorry you are having this problem. Chairman Ose is chairman of our new Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, and he will be watching and working on this problem over the coming months, and hopefully coming months, not more than a year.

For the last year we have held a series of hearings on energy policy. We held a hearing last summer on gasoline price spikes in the Midwest. We held another hearing in the fall on the problems with home heating oil and natural gas. We have real problems in those areas. And we do not have all the answers, but as a result of the hearings we have already held, we have been able to draw at least some conclusions. First, we need to develop our natural gas resources. We have tremendous deposits of natural gas in this country, but many of them are closed to development.

Almost all of the new electricity plants being built now are run by natural gas because it is clean. Demand is going up, as it is here in California, but new sources of supply are not being developed. The price of natural gas has more than tripled, and that is passed on in the form of higher utility rates. This has created severe hardships on lower income families. There are many areas that can be opened up to development without endangering the sensitive environments, and we need to do it, and we need to do it now, because it will help here in California as well.

We have to develop more refinery capacity. In 1982 there were 231 oil refineries in the United States. Today there are only 155. The demands we are placing on them is straining them to the breaking point. Because of all the environmental laws we have, refineries have to produce more than 50 different blends of gasoline for different seasons and regions of the country, and that is an amazing burden. We are stretched so thin that all it takes is one disruption in a pipeline or refinery to cause chaos. That is what happened in the Midwest last summer, and that is why they ended up paying more than $2 a gallon for gasoline.

The restrictions we have that make it so difficult to build new refineries are so counterproductive. Refineries built 20 or 30 years ago are dirty and inefficient. With today's technology, cleaner, more environmentally safe refineries could be built to replace them, but it is just not economical, and that has to change.

We need to have good, strong environmental laws, but we have to weigh the costs and the benefits. The new diesel fuel rule being developed by the EPA is a good example. Everyone agrees that diesel fuel needs to be cleaned up. The oil industry has offered a plan to remove 90 percent of the sulfur that is now in diesel fuel; 90 percent. Now, that is pretty good. But the EPA will not accept that. They are insisting on 95 percent. And yet, experts are predicting that the extreme measures they will have to take to get to that extra 5 percent are going to cause serious disruptions in our energy markets, and that will affect California as well. I think that decision needs to be revisited. I think we have enough problems to deal with, without creating new ones.

So we have learned a lot through this process, but we have yet to do a thorough review of the problems we have with electricity, and that is why we are here this week. If you want to learn about the pitfalls of electricity policy, California is the place to be. This is the laboratory, and the experiment is not going very well. We are not here to assign blame. We are not here to point fingers. We are here to listen and to learn and to try to find out ways that we might be of assistance.

There is going to be an important debate in Congress this year on energy policy. We have not had a serious energy policy in this country for too long. The Bush administration is going to offer a plan. Bills are now being introduced. We have some important decisions to make whether we are going to take the steps that are necessary to have energy independence and reliable supplies, or whether we will not, and that is why these hearings are so timely.

This is such an important issue that we created a new subcommittee this year, and I just mentioned that, the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, and I asked Mr. Ose to be the chairman of that committee, and I asked him to chair today's hearing. He has made this a top priority, and I think that is justified, and I think he will do a great job.

There are a lot of different issues for us to look at this week, and I will just mention a few. Why has demand grown so rapidly in California and supply grown so slowly? Were there early warning signs of this crisis that were missed, and if so, what were they? Should the Federal Government place a cap on electricity prices, or will this inhibit investment in new plants and exploration? Why were long-term contracts not locked in when prices were lower? Have power generators made excessive profits, and should they be ordered to repay some of that money? How are the utilities going to pay off their massive debts? We have just seen one company declare bankruptcy. Will there be more?

Over the next 3 days we are going to hear from all sides of this debate. Hopefully by the end of the week we will have answers to at least some of these questions. Today we are going to focus on the State government's role in handling the crisis. We are also going to look at how the U.S. Interior Department might be contributing to some of the problems. Tomorrow we are going to hear from the major utilities and the alternative energy producers. We will also question the chairman of the Federal Energy Regulatory Commission about their role. On Thursday we are going to have the major electricity producers, and we will have a lot of questions for them.

I want to thank all of our witnesses who are here today. We have some representatives from the local agricultural sector. I know they are having serious problems. Mrs. Lynch from the Public Utilities Commission had to rearrange her schedule to be here today, and we appreciate that. And to all our other witnesses whom I have not mentioned, I want to thank you for being here as well, and I look forward to hearing your testimony.

Thank you, Mr. Chairman.

Mr. OSE. Thank you. My good friend from Long Beach, I would like to recognize Mr. Horn for the purpose of an opening statement.

STATEMENT OF STEPHEN HORN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. HORN. I thank the gentleman. I want the people of northern California to know that in Mr. Ose they have a first-class legislator. He has been at everything we have done and we held 100 different hearings last year. And he asks first-rate questions. I am going to waive an opening statement, because I happen to believe in asking the questions, not talking myself. The chairman of the full committee has spoken for all of us. So, thank you very much.

Mr. OSE. Thank you, Mr. Horn.

All right, this committee swears its witnesses in, so we are going to have the three of you rise.

[Witnesses sworn.]

Mr. OSE. Let the record show the witnesses answered in the affirmative. I would ask that you summarize your written statement, try and keep it under 5 minutes. Mr. Yates, you are recognized.

STATEMENTS OF ED YATES, SENIOR VICE PRESIDENT, CALIFORNIA LEAGUE OF FOOD PROCESSORS; PETER VERBOOM, GLENN COUNTY DAIRYMAN; AND LEWIS K. UHLER, PRESIDENT, THE NATIONAL TAX LIMITATION COMMITTEE

Mr. YATES. Thank you, Mr. Chairman, Mr. Horn, Mr. Burton. Good morning. I am Ed Yates, senior vice president of the California League of Food Processors.

The food processing industry in California is sizable. It accounts for 40 percent of the Nation's domestic supply of processed fruits and vegetables. It is totally reliant upon an ample and adequate supply of energy to process the 16 million tons—16 million tons of perishable fruits and vegetables, converting that perishable product into safe and storable products available to consumers across the country at any time they wish to use them.

The current crisis in California is having a profound impact and presents a significant challenge to the food processing industry in California. We are facing rolling blackouts this summer. Our estimate is at least 30. These are extremely disruptive for a process, as Mr. Ose pointed out, where it may take, due to a 1 or 2 hour outage, 24 to 36 hours to bring the plant back on line. That represents as high as 24,000 tons of food that either gets thrown away or does not get processed. We have no protection currently from rolling blackouts, unless you wish to shed some load and participate in those kinds of programs.

Again, I want to emphasize the importance of supply. We are facing a prospect of having natural gas supplies curtailed or seized by utilities in California. The prospect of that is more than scary. We would not be looking at a 1 or 2-hour period of down time, like a blackout. We are talking days, and maybe weeks of unavailable supply of natural gas.

We are also extremely concerned about the price of natural gas. Currently the price is above $12 a dekatherm. That translates to almost $1 billion more in natural gas cost to the food processing industry if those prices were to prevail and be applied to everyone. We have a unique problem in California with the price of delivery of gas to the border. It exceeds the price of the commodity.

We are also very concerned with the effect in California that we have in competing with the electric generation industry. We compete with them on two levels: one for the price of the commodity, and second, for delivery. As the Federal Energy Regulatory Commission has opened up interstate pipelines to some reasonable form of competition, it is whomever can pay the most appears to get the highest priority for delivery. The food processing industry, being a relatively low margin industry, simply cannot compete with the prices that electric generators can pay for the commodity or delivery.

Food processors, I describe it this way, we are in a stainless steel straitjacket. We want the tools necessary to help ourselves get through this crisis. Yet in California, the very stringent regulations for air pollution and other considerations extremely limit our ability to help ourselves. We are making initiatives for alternative fuels. We are not getting a very open ear for that. We are simply locked into natural gas as a supply.

We did, in our prepared testimony, make four recommendations for consideration at the Federal level. We believe that the provisions of the Natural Gas Policy Act back in the old days which provided for a high priority for essential agricultural and food processing use of natural gas ought to be revisited, restored, and extended to the burner tips of food processors in California. We think that incentives ought to be created that would promote the use of alternative fuels for boilers and backup generation. We believe that someone ought to discover whether or not the high wholesale electric prices are reasonable and acceptable in terms of fair pricing and competition. We do support competition as long as it is fair and equitable and everyone has an opportunity to participate. We are in a symbiotic relationship with the grower community. We expect a number of processors may shut down this season, and we are hoping for some remedies to be forthcoming. And with that, I close, and again, I appreciate very much the opportunity to make these remarks today. Thank you.

Mr. OSE. Thank you, Mr. Yates. I was remiss in not introducing Mr. Yates. He is the senior vice president of the California League of Food Processors.

Our second witness is Mr. Peter Verboom, who is a dairyman from the great county of Glenn County in my district. Mr. Verboom, you are recognized for 5 minutes.

[The prepared statement of Mr. Yates follows:]

COMMENTS OF

THE CALIFORNIA LEAGUE OF FOOD PROCESSORS

BEFORE THE SUBCOMMITTEE ON ENERGY POLICY,

NATURAL RESOURCES AND REGULATORY AFFAIRS OF THE

COMMITTEE ON GOVERNMENT REFORM

CONGRESS OF THE UNITED STATES

HOUSE OF REPRESENTATIVES

ON APRIL 10, 2001 AT THE

SACRAMENTO CONVENTION CENTER, ROOM 204

TESTIMONY BY

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)ated: April 6, 2001

COMMENTS OF
THE CALIFORNIA LEAGUE OF FOOD PROCESSORS
BEFORE THE SUBCOMMITTEE ON ENERGY POLICY,
NATURAL RESOURCES AND REGULATORY AFFAIRS OF THE
COMMITTEE ON GOVERNMENT REFORM
CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
ON APRIL 10, 2001

Testimony of Ed Yates, Senior Vice President, California League of Food Processors, on the California Electricity crisis and the impact of the crisis upon California's food processing industry and related businesses.

I am Ed Yates, Senior Vice President of the California League of Food Processors. We as a not-for-profit trade association and represent nearly all the fruit and vegetable food processing activity in California. It is 40% of the United States production in the category. For many items, California food processors account for 100% of or close to it, the domestic supply of a variety of basic food products and components. While dominant domestically, we operate in a competitive global food supply system, which is challenged at every opportunity by international agreements, food safety episodes and the ongoing pursuit to keep trade open and free/fair. While respecting this dynamic, California food processors face a challenge for survival. It is presented to them by government. It has never been encountered to such serious and critical degree before.

Energy is essential for the processing of perishable food into safe, storable products, available for all users, consumers of food, at any time. Such processed products result from a huge capacity to process vast quantities of perishable food during the short period of time available during harvest.

Attached is copy of "Energy Crisis Impact On The California Fruit And Vegetable Processing Industry" and an economic report by California Commerce Agency on the industry. Also, a breakdown, by county, of the wages paid to the workforce employed by the food processing industry.

Food processors are facing:

1. As summer-seasonal users of electricity, we are being saddled with a huge debt for electric supply. This winter supply was delivered to other customers. We are being required to pay for it.

2. Proposed electric rate increases for summer on-peak hours which approach 600%. Food processors operate around-the-clock. We cannot shut down ¼ (6 hours) of the day to avoid extremely high rates. Rates which are proposed to increase 10 times more than the 3¢/kWh average placed on others.

   To shut down ¼ of a day translates to 2,000 truckloads of food a day or seasonally, 4,000,000 tons of perishable food left to rot in the field. **NOT ACCEPTABLE.**

3. Shortage of electric supply means, in our estimate, 20-30 rolling blackout days this summer—maybe more. Shut down a tomato paste plant and it's 24-36 hours to clean out the sterile system and restart it.

4. Competition for natural gas supply from electric generators. The California Public Utilities Commission is poised to give them priority for delivery over food processing. The utilities can now seize our gas if they want it. We have no protection. What good does it do to give gas to electric generators and shut us down with no gas. Federal protection for natural gas delivery for food processing ought to be revised and extended into California.

5. Costs for natural gas are currently 20 times higher than historical experiences. Half of the increase is for delivery to the California border. Interstate transportation costs exceed the cost of the commodity. Use of alternate fuel is limited.

What should be done at the Federal level?

1. Ensure highest possible priority for delivery of natural gas and electricity to food processors.
2. Address the extremely high costs for delivery of natural gas via Interstate pipelines to the California border.
3. Consider incentives and programs to assist food processors in using alternate fuel and energy sources.
4. Discover whether or not high wholesale electric price is the result of reasonable and acceptable practice.

CLFP appreciates the opportunity to present these views and would look forward to responding to any questions.

Respectfully submitted,

Ed Yates

Ed Yates, Senior Vice President
California League of Food Processors

Dated: April 6, 2001

California League of Food Processors
February 2001

ENERGY CRISIS IMPACT ON THE CALIFORNIA FRUIT AND VEGETABLE FOOD PROCESSING INDUSTRY

INTRODUCTION AND BACKGROUND

The California fruit and vegetable processing industry is experiencing an energy crisis of unprecedented proportion. The natural gas and electrical situation from a supply and cost standpoint is extremely volatile and can be expected to remain so for 18-36 months, perhaps longer. This results in significant challenges for food processors and could mean low to no production, thus impacting the supply of processed tomatoes and tomato products, processed fruit and vegetables to not only California, but the nation as well. California accounts for more than 40% of the nation's production of processed fruits and vegetables. Further, California's food processors provide the following percentages of US production: tomatoes – 95%; black ripe olives – 100%; peaches – 100%; apricots – 100%; fruit cocktail – 100%; pears – 40%; prunes – 100%; strawberries – 90%; pistachio's – 100%. The industry's energy use is highly seasonal—80% of natural gas and 60% of electricity is used during the peak summer season, typically mid-July to mid-October.

The California food processing industry faces competition from both domestic and foreign producers. The global competition is fierce. High energy costs place California food processors at an enormous disadvantage. California food processors have cut their energy use in half over the past 20 years. This is in large part because they are sensitive to energy costs and new investments in increased productivity and efficiency have contributed to competitiveness.

Above all, a reliable supply of energy is critical to the future of California's food processing industry.

THE CHALLENGE

The California Energy Commission has forecast gas costs to return to pre-2000 levels sometime after 2003. Low natural gas prices in the past, reduced drilling activity which caused production capacity to lag behind growth in demand. High natural gas prices have increased drilling activity. It is expected these new wells will have a dampening effect on price at some point in the future. New electric generation is gas fired, putting further demand on pipeline capacity. This means food processors could face three years, if not more, of high natural gas costs.

Similarly, in California there is a shortage of electricity given the increases in demand over the past few years, without supply to meet the growing needs of the state. This shortage combined with the implementation of deregulation has resulted in extremely high prices for customers irrespective of season or even time of use. Since significant amounts of additional generation is not expected to come on line until 2004 and later, food processors will face several years of high electricity prices and a very high likelihood of interruptions and curtailments.

High gas and electricity prices for the food industry, a competitive, low-margin business will not only be challenging, but will likely put many companies out of business, impacting the food market in California and the nation. Several have already suspended operations.

The industry uses approximately 300-400 million therms of natural gas and 600-800 million-kilowatt hours of electricity to process 16-18 million tons of food each year. Prior to 2000, the annual cost for natural gas was around $90 million. For 2000, price increases resulted in a 50% increase to $135 million. At prices anticipated for the 2001 summer processing season, gas costs are expected to be $215 million. This would be nearly a 150% increase over historical figures.

For electricity, the current costs are about $70 million. At wholesale generator prices being experienced since June 2000, electric costs could increase 100% to $140 million in the event the rate freeze ended. If this was to occur, the cumulative effect results in 2001 costs for both natural gas and electricity would be about $355 million, a $195 million or 120% increase over past experiences.

Compounding the situation is the fact that virtually all raw product and supplies (containers, ingredients, labels, etc.) are relatively energy intensive as well and will experience these same high costs.

Food processors face huge challenges with these high costs. **Many are not expected to survive.** Food processors need the ability and tools to address high energy costs and short supply. Historically, one of the most effective methods for reducing natural gas costs has been the use of alternate fuel. Due to increased air standards, the ability to use alternate fuel has diminished.

High priority should be given to food processors for energy needs. The provisions of the Natural Gas Policy Act of 1974 (Federal) should be applied in California. It provided agriculture and processing of agricultural products a high priority for natural gas delivery to insure full food production and processing. The same concept should extend to delivery of electricity. It makes little sense to grow an energy intensive and perishable food then waste it by interrupting the processing and preservation of it.

A few examples of estimated effects of high-energy costs on the industry are as follows:

TOMATO PROCESSING

PER THERM	PER POUND OF PASTE	ADDED COST PER 10,000,000 TONS
$0.30	$0.012	
$0.40	$0.016	$16,000,000
$0.45	$0.018	$24,000,000
$0.80	$0.032	$80,000,000
$1.00	$0.040	$112,000,000
$2.00	$0.080	$272,000,000
$3.00	$0.120	$432,000,000

NOTE: At a price of $1.00 per therm, some tomato processors have indicated they are not likely to process any products.

PRUNE PROCESSING

Natural Gas average usage 2000 crop		PROJECTION			
PER GREEN TON	Therms	Price/Therm	% Increase	Gas Cost	Total Cost
Therms per ton average 27	27	$0.452	2000 crop	$12	$51
Price as used equal $0 .452	27	$0.497	10%	$13	$56
Natural Gas cost per ton equaled $12	27	$0.565	25%	$15	$63
Natural Gas equals 24% of total cost/ton	27	$0.678	50%	$18	$76
	27	$0.791	75%	$21	$89
	27	$0.904	100%	$24	$102

Electric kWh average usage 2000 crop					
PER GREEN TON	kW	Price/kW	% Increase	kW Cost	Total Cost
kW per ton average 25	25	$0.168	2000 crop	$4	$51
Price to kW average $0.168	25	$0.185	10%	$4	$56
kW cost per ton equaled $4	25	$0.210	25%	$5	$63
kW equals 8.2% of total cost per ton	25	$0.252	50%	$6	$76
	25	$0.295	75%	$7	$89
	25	$0.337	100%	$8	$101

NOTE: At a price of $1.50 per therm and 25 cents per kWh, prune processors are not likely to process any product.

FROZEN VEGETABLE PROCESSING

It is estimated that if average costs for 2001 energy, using natural gas at $1.70 per therm and electrical at $.17 per kWh, will increase the production costs of frozen vegetables in excess of 5 cents per pound or a 8-12 percent increase.

At current spot prices, these three major food items will experience cost of production increases ranging from 4 to 35%.

DUE TO HIGH COSTS AND THREATENED SUPPLY PROBLEMS OF NATURAL GAS, THE FOLLOWING ACTIONS SHOULD BE TAKEN:

1) The governor should declare a state of emergency for natural gas the same as has been declared for electricity.

2) Food processors should be given the highest possible priority for delivery of natural gas. NO DIVERSIONS!

3) Expedite action and approval, together with flexible air regulations to install and operate alternate fuels. Offset requirements should be given a period of 5 years to achieve compliance, whereas currently it's an immediate requirement. This could include traditional emissions credits such as mobile stationary or indirect sources.

4) Access to ALL alternate fuels should be facilitated. This includes, diesel, No. 6 oil, propane, biomass, coal, etc.

5) Cogeneration and other multi-use of fuel should be enhanced and encouraged by regulatory relief.

6) Additional gas pipeline capacity into California and other gas transportation shipment modes should be promoted, encouraged and facilitated. This should extend to all fuel types.

7) California's natural gas production potential should be stimulated, including Federal and State lands, onshore and off. The governor should direct the appropriate State agencies (Department of Conservation, CEC, etc.) to conduct an assessment of production and the potential production of California natural gas.

8) Sales and use taxes on natural gas should be capped to pre-2000 levels or suspended until the crisis is over.

9) A review of the need and necessity of surcharges on natural gas rates as required by the CPUC or current law should be conducted (EOR,etc.)

DUE TO LOW AVAILABILITY AND HIGH COST OF ELECTRICITY,

10) Food processors should be given the highest possible priority and not be shut off! If rolling blackouts occur, a minimum of 6 hours advance notice should be provided.

11) Back-up, emergency or self-help generation of electricity should be authorized immediately.

12) Cogeneration and other multi-use of fuel should be enhanced and encouraged by regulatory relief.

13) Curtailable and peak-shaving programs providing appropriate economic incentives at the customer's option should be developed for reducing load.

14) Sales and use tax on electricity should be capped to pre-2000 levels or suspended until the crisis is over.

15) Food processors should be given equal access to lower cost electricity and any increases in cost should be shared equitably among all customer groups. This means no discrimination among customer classes and any increase in rates, if necessary, should be on an equal percentage per kWh basis.

16) The State's problems, bottlenecks and upgrades of electric transmission system, as assessed by the ISO, should be addressed immediately. In particular, Path 15 should be given priority attention.

17) A review of the need and necessity of surcharges on electrical service should be conducted.

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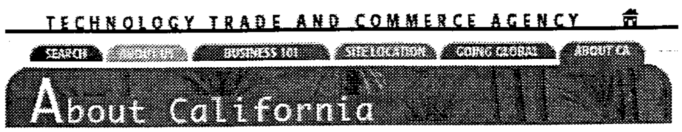


The California Food Processing Industry

(prepared by the Office of Economic Research)

Introduction California is the top agricultural state in the nation, a position it has held for 50 years. As a natural result, California is also the largest food processing employer in the United States. With an enormous variety of crops, great growing conditions and increasing demand for prepared food products, California is the center for food processing, shipping $50 billion worth of food products.

Definition Food processing is an umbrella term used to describe all the activities of manufacturing food and beverages for human consumption, as well as prepared feeds for animals. California processing includes fruits and vegetables, baked goods, meats, dairy products, sugar and confections, beverages, and fats and oils. The industry is defined as food and kindred products by Standard Industrial Classification (SIC) code 20.

Size and Location Food processing firms in California are as widely spread across the state as the farmlands that supply them. Food manufacturers purchase most of their perishable raw materials from area growers, ensuring the ultimate in freshness.

California is the top producing state for many fruit and vegetable crops, providing the basis for myriad fresh, canned and frozen products. Correspondingly, preserved fruits and vegetables is the largest industry group in California food processing, providing a quarter of the state's food processing jobs.

Regionally, the processing of fruits and vegetables is especially significant in the counties of the San Joaquin Valley, Sacramento Valley, and Central Coast. The San Joaquin Valley, and in particular, Fresno County, leads the rest of the state and the nation in food production. The San Joaquin Valley includes six of the top ten agricultural counties in California. Fresno County alone shipped $770 million of preserved fruits and vegetables.

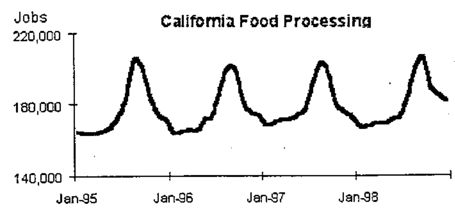
Beverage manufacturing provides 19 percent of the food processing employment in California, led by the high value-added wine production. Over 65 percent of the U.S. wine production employment is in four California counties; Napa, Sonoma, Stanislaus and San Joaquin. The manufacture of soft drinks is the second largest beverage employer.

Bakery products in California provide 13 percent of the state's employment in the manufacture of those products. Bakeries, and sugar and confectionery producers use sugar beets processed in Fresno, Imperial and San Joaquin Counties. Bakeries and confectionery producers can add roasted nuts processed in Madera, San Joaquin, Stanislaus, Tulare and Sacramento Counties.

California also has above-average representation in canned and cured seafood processing located in the coastal counties, and pasta production in Los Angeles, Orange and Alameda counties.

Economic Importance CCalifornia produces a wide variety of food products and is the leading state in many food categories. California surpasses Wisconsin in milk production. California is the only producing state of such specialty foods as almonds, artichokes, raisins, prunes, olives, dates, figs and pistachios.

California food processing employed 183,300 people in 1999, composing 11 percent of the nation's total. Seasonal harvesting results in an annual employment surge in the late summer, as illustrated in the graph below. In addition to actual harvesting, the food processing industry provides thousands more jobs in directly related industries such as food wholesaling and retailing. More jobs are linked through manufacturers of packaging materials, industrial and agricultural chemicals, biotechnology products, and farm and food production machinery. Still more jobs are indirectly related to food processing; including grocery stores, eating and drinking places, hotels, grocery wholesaling, trucking and warehousing, and hospitals.



Examples of Product Leadership California's famous produce are the ingredients in everything from soup to nuts. Crops grown in California may be lightly processed, or go through many steps before reaching market. Examples of lightly processed products are raisins, dates, prunes, almonds and walnuts from the state's giant cooperative processors, such as Sun Maid Raisins, Blue Diamond Growers, and Diamond Walnut Growers.

Further processing makes California crops major ingredients in other nationally known foods. For example, Campbell Soup and La Victoria Foods use locally grown tomatoes and other vegetables for their soups, "V-8" juice and salsa. Odwalla Fruit Juices use fruits and vegetables primarily grown in the Central Valley.

California-grown rice, corn and potatoes are the main ingredients in snack foods made by Quaker Oats Rice Cakes and Frito-Lay. See's Candies uses the state's famous raisins and dates, in addition to local nuts and cream. Milk processed in the state goes into Kraft cheese products, Haagen Dazs ice cream, Land-o-Lakes creamery products and Hershey's chocolates. Hershey's is also the nation's largest user of California almonds.

International Trade and Investment The export market holds the greatest potential for expanding sales of California agricultural products with a world market of six billion people. California is the leading agricultural export state and the sixth largest exporter in the world. In 1999, California exported $4.4 billion worth of food and kindred products. The export volume was down 17.2 percent from 1998, though total exports were up 2.4 percent. Food products were the fifth largest export after electronics and transportation, and represented 5 percent of total California manufactured exports.

Agricultural products are one of the few U.S. industries to enjoy a positive trade balance, and highlight the important role agriculture plays in the thriving California economy. California is expected to continue its positive contribution to the U.S. trade balance as worldwide demand increases for high-value agricultural products. California products with the fastest growth are those with the highest value added: canned fruits and vegetables, wines and frozen foods.

Japan was the single largest market for California food and kindred products. Purchases in 1999 exceeded one billion dollars, or one quarter of the total California exports of food and kindred products. Canada was second with purchases totaling $683 million, or about 16 percent of the total.

Infrastructure As with other industries, California universities and colleges conduct research and development on agricultural products and food processing. One of the most renowned research facilities is the University of California at Davis. The University currently has projects underway to improve the quality and shelf life of processed foods, such as sliced melon and fresh-cut peppers, while maintaining their healthful qualities.

Food processors incorporate new research in their efforts to maintain the high quality of the products and create new ways to market existing products. Two examples of relatively new marketing are the lunchbox packs of fresh carrots, and premixed salads in "breathable" plastic bags. Packaging that makes life simpler for time-constrained families will boost consumption of processed foods.

The processing of fresh fruits and vegetables to maintain appearance, aroma and flavor is especially important to the state's growing demand for exports. To facilitate the sale of foods, California has a well-developed infrastructure of processing, packaging, storage, loading and shipping facilities. In particular, some products are picked and packaged right in the field, while many others are processed at plants adjacent to the fields. These methods further expedite the movement of farm-fresh products to market.

The business climate in California has improved in recent years. Tax credits, manufacturing credits and employment training funds, among other incentives have attracted new businesses and encouraged expansion of existing businesses. Some of the food processing giants that have recently expanded operations in California are Blue Diamond, Land O' Lakes, Campbell Soup, Frito-Lay, Mission Foods and Dole Vegetables.

Trends The demand for processed foods is driven, in part, by the increased demand from two-worker families, and single parent families with less time available for shopping and meal preparation. Pre-packaged salads, and pre-sliced vegetables combined with fresh meat create nutritious meals in minutes.

The market for U.S. processed foods is largely domestic with a national market of 250 million people. California is itself a ready market with 34 million residents. Domestic demand for fresh fruits and vegetables, where California is at its competitive best, continues to grow. California research continues to find new ways to increase crop yields and preserve freshness and flavor, while using fewer pesticides and herbicides.

California agriculture is characterized by high-yielding, high-value cash crops that use advanced levels of technology, capital and management. High per-acre yields are an important contributor to the state's consistently high farm revenues. California exceeds the national average in yields per harvested acre in several major crops.

California Food Processing Industry (SIC 20)
Establishments, Employment, and Wages, 1998 ES-202

(S denotes suppressed data)

Region	S	No. of Establ.	Annual Employment	Annual Payroll	Avg. Annual Wages
Statewide		3,272	181,199	6,140,059,925	33,886
Alameda		178	12,453	432,173,594	34,704
Amador		9	97	1,795,155	18,507
Butte		21	1,083	27,023,346	24,952
Calaveras		4	171	2,693,550	15,752
Colusa		10	509	14,994,816	29,459
Contra Costa		44	1,809	92,525,601	51,147
Del Norte		6	152	2,613,448	17,194
El Dorado		15	128	3,614,149	28,236
Fresno		139	11,448	321,232,298	28,060
Glenn		10	335	13,208,234	39,428
Humboldt		26	690	13,136,320	19,038
Imperial		13	486	13,733,187	28,258
Inyo	S	-	-	-	-
Kern		35	1,537	53,468,455	34,788
Kings		21	1,650	47,818,483	28,981
Lake		5	153	4,257,493	27,827
Los Angeles		759	46,425	1,766,228,705	38,045
Madera		18	1,270	35,433,376	27,900
Marin		20	198	4,789,318	24,188
Mariposa		3	11	108,477	9,862
Mendocino		43	1,279	30,518,561	23,861
Merced		41	7,658	182,738,866	23,862
Modoc	S	-	-	-	-
Monterey		55	3,642	97,235,160	26,698
Napa		151	5,786	213,558,046	36,909
Nevada	S	-	-	-	-
Orange		186	8,788	291,630,840	33,185
Placer		8	35	915,208	26,149
Plumas	S	-	-	-	-
Riverside		72	2,665	85,546,363	32,100
Sacramento		59	5,020	177,042,662	35,267
San Benito		7	376	9,789,145	26,035
San Bernardino		100	3,691	114,311,395	30,970
San Diego		133	4,602	125,155,583	27,196
San Francisco		134	3,105	127,557,057	41,081
San Joaquin		86	7,773	274,278,081	35,286
San Luis Obispo		50	674	16,528,433	24,523
San Mateo		82	3,285	125,692,851	38,263
Santa Barbara		44	1,378	34,795,568	25,251
Santa Clara		102	4,674	145,593,203	31,150
Santa Cruz		41	2,458	62,814,466	25,555
Shasta		10	163	5,564,129	34,136
Siskiyou	S	-	-	-	-
Solano		32	2,805	115,405,188	41,143
Sonoma		169	6,667	206,820,571	31,022

California Trade and Commerce Agency
Office of Economic Research

California Food Processing Industry (SIC 20)
Establishments, Employment, and Wages, 1998 ES-202
(S denotes suppressed data)

Region	S	No. of Establ.	Annual Employment	Annual Payroll	Avg. Annual Wages
Stanislaus		86	15,208	518,945,390	34,123
Sutter		13	774	28,842,021	37,264
Tehama		5	41	1,059,948	25,852
Trinity	S	-	-	-	-
Tulare		59	3,733	123,620,419	33,116
Tuolumne	S	-	-	-	-
Ventura		41	1,272	50,078,156	39,370
Yolo		24	1,562	56,441,013	36,134
Yuba		5	314	8,669,068	27,608
Unknown Or Undefined		89	900	53,452,403	59,392

Mr. VERBOOM. My name is Peter Verboom. I am actually relocating my dairy from San Diego County to Glenn County. I have to apologize, I did not bring my written statement, if that is OK.

Mr. OSE. Arrest this man—yes it's OK. [Laughter.]

Mr. VERBOOM. Being from San Diego County, when San Diego Gas and Electric went to deregulation my cost on my dairy facility in San Diego County tripled. They went from $3,500 a month to over $10,000 a month. And there is no way that we can pass on those costs with our milk prices being controlled. The wholesale milk prices are regulated by the State, where the retail prices are not, and so we have no way of passing on those costs through our product. And so we have to absorb them. It does not work, especially given the cost of milk prices as they have been in the last year.

And moving my facility from to northern—I am in the process, actually. We were moving cows last night at midnight, and we are in the process of moving our herd up. And so I will be able to get a clear picture of the difference between SDG&E and PG&E, and I am kind of wondering what to expect.

And so it has been—as far as having the power at the dairy, we do have generation facilities at the dairies. But, on the other hand, in this past year in the rolling blackouts that we have had, I produce milk for Land-O-Lakes. And, Land-O-Lakes has a large facility in Tulare. In Tulare, with the brownouts, their milk backed up on them, and when the milk backed up, they were not able to pick it up at the dairies. A certain amount of dairies had to dump their milk, and then also faced the possibility of regulations from the Water Quality Control Board for contaminating the groundwater. So, it has been a problem. It kind of just feeds on itself all the way down the line.

But my initial statement is that we—as a producer, I have no way to pass it on. And so, I wanted to relate that message to you. With the milk storage problems, we cannot—that is basically my opening statement. I will be open for questions. I am sorry I did not have a prepared statement with me.

Mr. OSE. That is fine. Thank you, Mr. Verboom.

Our third witness is Lew Uhler, who is the president of the National Tax Limitation Committee. He lives in this area. Welcome.

Mr. UHLER. Thank you, Congressman, and Congressmen Burton and Horn, for inviting us to do our best to represent the viewpoint of taxpayers here in California. We are a national committee. We keep our headquarters here in the Sacramento area, with tens of thousands of members in this State and elsewhere. We have been in operation for the last 25 years, and I am proud to say we do not accept any government grants or contracts, Federal, State, or local, but are supported only by voluntary contributions of taxpayers.

The gravity of this situation is lost on no one. We know that the electric and other energy situation we face now is the result of a flawed deregulation program: frozen rates; requirements that electrons be purchased on the spot market rather than long-term contracts; and a peculiar method of financing the daily or hourly requirements by paying everybody the highest rate paid to any provider, instead of a blended rate with some of the lower cost power being blended in to bring the average rate down.

So, we confront a huge substantive, the politicians and the Governor, political situation. Rather than accepting the reality of the problem and choosing a market-based solution, the Governor and the majority leaders of the legislature have chosen a command economy approach as the solution. And in doing so, they have opted to place the burden, not on the ratepayers, but on the taxpayers of the State.

Now, there is some overlap, of course. But since 25 percent of the generation in the State is by municipal utilities which are not caught up in the stupidity of the deregulation plan and its execution, they confront a different rate structure than others do. And yet they are being asked, as taxpayers, to bear some of this burden, I think mainly because they have been around and they are credit-worthy. What the political process in Sacramento has been doing is looking for credit-worthy people to turn to. Hence the public treasury is now obligated to pay tens of billions of dollars for current and future electricity costs.

From this moment forward, we have a chance to improve the situation. We ought to be guided by the medical Hippocratic oath, "first do no harm." And yet yesterday the Governor did further harm by proposing—and of course the legislature will dispose—that the people of the State, wearing their taxpayers' hats, should purchase an antiquated grid system from part of the electricity distribution system. So, it appears that the Governor is not learning. He is creating a further nightmare for the taxpayers. We should have learned, from the decline of the Soviet Union, that command economies do not work. Free markets do. We have to adopt free market solutions.

So, I think the real answers here are twofold. First, I urge that we turn to the truly credit-worthy buyers, the individual residential consumers, the businesses, cities, and all the rest, and use their credit. Let their credit be used to buy electricity directly from the suppliers, negotiating contracts to benefit themselves.

When we started this crazy deregulation, we had limited direct access. Less than 2 percent of the residential users opted for alternative suppliers. Why? Because there was no price differentiation. We froze the rates as requested by the utilities. They have caused this problem now visited on them, to a large degree. In terms of the industrial and commercial users, 25 to 27 percent of the larger users actually entered into direct access contracts. When the State passed AB1X, the so-called "relief act," they foreclosed the opportunity for direct access. So one of the things we must do is to reverse that action and give all of us the opportunity to go directly to Enron or Reliant, or whomever and make the best deal we can. That may not stop blackouts, but we can also negotiate contracts, with the possibility of limiting the blackouts, at least during this time.

Second, as with retailing, there are three things that are important: location, location, and location. There are three things that are important in solving this problem: supply, supply, and supply. What we have to do is get more power out of existing generators. As our friend who runs the California League of Food Processors, Ed Yates has said, we simply are being inundated with rules and regulations by local air quality control management districts they have to be disciplined into some system.

And we call on the Governor to ask you for relaxation of the clean air rules. In turn, under his emergency authority, he should relax the Clean Air Act requirements here in California, discipline the local air quality management crowd into a system, and get them to produce and continue to produce. Then, of course, we need to build a new facilities, nuclear, hydro, etc. And I would urge that the Auburn Dam be one of those considered for the long-term benefit of this State. Thank you.

[The prepared statement of Mr. Uhler follows:]

the national tax-limitation committee

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TESTIMONY OF LEWIS K. UHLER
BEFORE THE
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
April 10, 2001
Sacramento Convention Center
Sacramento, California

Mr. Chairman and Members of the Committee:

I am Lewis K. Uhler, President of the National Tax Limitation Committee.

I appreciate the opportunity to appear before you and to offer some thoughts and recommendations regarding the energy crisis in California.

First, let me say that our Committee, while national in nature, keeps its headquarters in the Greater Sacramento Area and has many thousands of supporters in this state. The Committee is funded solely by voluntary contributions of individuals and organizations and receives no funds from any government, including the federal government, whether by grant or contract.

You are holding this hearing here in California because you understand the gravity of the situation we confront. We are on a collision course between bad government policy and mismanagement and the economic and physical well being of our citizens. As you, our federal representatives, consider the problems and the options, I urge that you heed the exhortation of the medical profession's Hippocratic oath, **"first, do no harm."** While state leaders may have approached the problem with helpfulness in mind, they have, in fact, harmed us in very fundamental and serious ways.

For years, California ratepayers have been the victims of high utility costs imposed largely by environmentalists' demands and stratagems. Windmill farms, solar energy experiments, lawsuits against building hydro facilities, regulatory delays in nuclear facilities and much more have combined to drive energy costs in California to more than 50% above our neighboring states. Therefore, energy deregulation was a necessary and proper step for Californians.

Unfortunately, as virtually everyone now understands, the electricity deregulation scheme adopted mid-last decade was fundamentally flawed. It violated free-market principles in its design and execution:

- It froze residential retail electricity rates (for the benefit of the utilities), thereby preventing meaningful opportunities by residential electricity customers for **direct access** to competing suppliers. Less than 2% of residential customers signed up with alternative suppliers (while commercial users especially the larger ones – were using their direct access in meaningful numbers). Had free-market price competition accompanied direct access, the opportunity for residential customers to change suppliers would have kept rates down, as they have with long distance telephone service.

- The deregulation scheme created a supply "choke point," in that it required all electricity to be purchased through the newly created power exchange (PX) and to be purchased daily – essentially on a spot market basis – not on long-term contracts.
- Pricing was turned on its head. Instead of a blended hourly or daily rate based on low-cost hydro and nuclear averaged with higher cost alternative energy generators, the highest price paid to one was paid to all for that period.
- It did nothing to increase electricity **supply** despite rapidly increasing energy usage.
- It did nothing to discipline local air quality management control districts, which, acting independently of one another, curtailed the availability of power from otherwise operational facilities, while environmentalists fought the siting of new power plants.
- It did nothing to prevent the requirement that existing generators, fired by natural gas and other fuels, be converted to gas only, leaving us completely vulnerable to the vagaries of natural gas supplies and price, driving up the price of electricity and the cost of natural gas needed to heat homes and drive industry.

State government's reaction to the crisis has become even more anti-market, making matters worse and creating taxpayer victims, as well. The decision-makers in Sacramento – the Governor and the majority in the State Legislature – who view the public treasury as their "private hunting preserve" -- have been buying power for ratepayers and bankrupt utilities, using taxpayer funds. And they resisted rate increases that are – unfortunately for ratepayers – the very signals needed in a market system to achieve equilibrium between supply and demand and to avoid undue blackouts. "Voluntary" conservation may sound good, and evoke an emotional response, but people really pay attention to **price**.

The decision-makers' response has been designed to curtail political "damage" to themselves at taxpayer expense. They have breached their fiduciary duty to taxpayers. We implore them not to exacerbate this problem by buying the state electricity transmission system in an effort to further "bail out" the utilities with taxpayer resources, nor to set up a state power authority to generate electricity. Not only are these improper uses of taxpayer funds, but they also discourage construction of new generators in California. And talk of "seizing plants" will assure that major power companies will avoid California like the plague.

In pursuit of abundant, reliable and cheap electricity – the hallmark of an advanced, civilized society – we must let the market work. Here is a menu of items for government officials that will be beneficial and do no harm:

- **Allow direct access of customers to suppliers** – The Governor and the majority in the State Legislature must stop trying to intervene as a "credit-worthy" buyer of electricity (Wall Street's reaction to the proposed California revenue bonds seems to cast doubt on the state's financial reliability in this situation) and allow the real credit-worthy customers – residential, commercial and industrial users in California – **direct access** to those who generate electricity to negotiate their own contracts. This right was discouraged/limited in the original deregulation bill and abrogated in AB1X. Essentially, **all** California users of electricity have been shackled and placed in bondage, unable to fend for themselves.

  Direct access must be restored as quickly as possible. Only in this way can we halt the hemorrhaging of the public treasury, where $50 million or so per day of taxpayer funds are being used to buy electricity. Ratepayers must have the authority to purchase power directly from suppliers. (The bankruptcy court will have to sort out the competing claims of the distributors, generators, etc., as to past energy purchases, prices and so-called "windfall profits".)

- **Eliminate barriers to energy supplies** · State government should take an **active** role in tearing down the barriers to a greater **supply** of energy. A major cause of the current energy problem is that government environmental regulations, the disjointed air quality management regulatory system in California, energy facility siting rules and practices, environmental group lawsuits and lobbying, etc., have prevented the construction of any new major power plants in the last decade. California state government must change course and help us out of this fix in three distinct ways to increase supply:
    1. it must help maximize the power production potential of all **existing** generating facilities that are often taken off line by local air quality control districts;
    2. it must facilitate the permitting of **temporary** facilities, such as turbines brought into various harbors on barges, etc.;
    3. it must accelerate permitting and siting of **new** generating capacity (for energy consumers in California to be able to negotiate good long-term electricity contracts, with the best current rate, the market must be convinced that supply will soon be abundant).

To accomplish these objectives, the Governor must do the following:

1. request that the Administration in Washington waive provisions of the Clean Air Act, especially during Stage 2 and 3 alerts, so plants can run continuously without the heavy emissions fines and credit requirements which have led to extensive shutdowns and added substantially to the price of electricity;
2. use his emergency powers to relax the California Clean Air Act so its requirements are not a barrier to the operation of generating facilities;
3. use his emergency powers to integrate the actions of the air quality management districts into a single statewide system so priority can be given to meeting the state's energy needs;
4. order that temporary turbines, mounted on barges, be used to augment coastal production, and work with the United States military to tie in naval and other generating capacity to meet peak demand;
5. use his emergency powers to assure that the California Energy Commission will site new generating facilities quickly and in specific areas, preempting local environmental and land use opposition, so plants can be constructed near the user base;
6. lift the veil of secrecy surrounding his power purchases and contracts to date so California taxpayers can know where we stand.

With respect to those things that the federal government can do to relieve the energy crisis in California, we suggest the following:

- Upon the Governor's request to relax requirements of the Clean Air Act to facilitate electricity generation in California, the President, Congress and the Federal Energy Regulatory Commission (FERC) should respond with the necessary waivers, regulatory adjustments and congressional actions;
- That FERC facilitate and assure that California electricity consumers will have direct access to generators, engaged in interstate commerce, who are willing to contract directly with users;

- That hydroelectric facilities, which will also conserve and protect our precious water resources, be sited and approved as quickly as possible. This should start with the much-delayed Auburn Dam.
- That the Nuclear Regulatory Commission reviews the list of closed nuclear facilities to determine which, if any, could be quickly brought back on line.
- The Administration should include new nuclear generators in its energy plan for America's future in order to provide non-fossil-fuel dependent, clean energy supplies.

Immediate action as outlined above is essential if the adverse impact of this crisis on California's taxpayers is to cease. This is not a taxpayer problem, and the taxpayers should not be asked to bear the brunt of its solution.

Mr. OSE. Thank you, Mr. Uhler. We will now entertain questions from the Members. We are going to do this in 10-minute sections. I want to recognize the gentleman from Indiana first for 10 minutes.

Mr. BURTON. Let me start with Mr. Verboom. You said that Land-O-Lakes, which is a purchaser of milk products from you—one of your larger milk purchasers—because of the blackouts they had milk spoil.

Mr. VERBOOM. Yes.

Mr. BURTON. And they had to dump it. And when they dumped it, then they ran into an environmental problem because of the pollution of the water supply.

Mr. VERBOOM. Let me back up there. The plant itself did not dump the milk. They lost the capacity to bring in anymore milk from the dairies.

Mr. BURTON. So the dairies had to dump it?

Mr. VERBOOM. The dairies had to dump the milk.

Mr. BURTON. And so all the dairy producers were then in violation of the environmental rules?

Mr. VERBOOM. Yes.

Mr. BURTON. And you said your rate in San Diego went up 300 percent? Three times?

Mr. VERBOOM. It multiplied three times; yes.

Mr. BURTON. OK. So is that the main reason you are relocating north?

Mr. VERBOOM. No. I was in the process of relocating, but it has become a very good reason to—San Diego County, where we were located, is not very conducive to dairies.

Mr. BURTON. And you stated that there is a ceiling on the wholesale price set by the State, so you have to eat the loss——

Mr. VERBOOM. Yes.

Mr. BURTON. [continuing]. When you have to destroy milk or get rid of milk that is spoiled?

Mr. VERBOOM. Yes. Well, it gets—Land-O-Lakes being a cooperative, it gets distributed amongst all the producers, so all the producers bear the loss.

Mr. BURTON. OK. But also the electrical cost, also you have to eat that?

Mr. VERBOOM. I have to eat that, yes. Oh, definitely.

Mr. BURTON. Because of the price ceilings.

Mr. VERBOOM. Yes.

Mr. BURTON. It sounds like there are other problems besides just generation of electricity you have to deal with there.

Mr. VERBOOM. Yes.

Mr. BURTON. Mr. Yates, you said that alternative fuels should be allowed to be used, but there was a problem with environmental laws in the State. Could you elaborate just a little bit on that?

Mr. YATES. Thank you. In California there are standards for the use of alternative fuels. However, the problem is if you were to put in the equipment to utilize those fuels and they happen to result in an increase of emissions, you have to, before you install the equipment, make arrangements to offset that increase of emissions. We think that we are not asking that those requirements be eliminated. We simply ask that more time be allowed to acquire those emission offsets, rather than having to do them up front.

Alternate fuels have historically been an effective and very viable means of fighting high costs for natural gas. The air regulations in the State—in California have been tightened up, so many food processors have lost their ability to utilize alternative fuels, and natural gas has been plentiful, reasonably priced, and so there was no need. Obviously there is a need now to look——

Mr. BURTON. And the utilities are using a lot of natural gas?

Mr. YATES. That is correct. As I mentioned, there is an increasing demand not only by the utilities to satisfy what they call the core, which are residences and small businesses, but also electric generation. All those loads are increasing, and we set with the high probability that the utilities could seize our gas to satisfy the needs of the core group. In addition, the Public Utilities Commission in California has proposed a rulemaking which would give electric generators higher priority than we have for natural gas supply. It does us no good to have a supply of electricity if we have no gas to process the food.

Mr. BURTON. So, you think you should be treated equally, along with the utilities?

Mr. YATES. At minimum. That is correct.

Mr. BURTON. Let me ask one more question of you, and that is, we have tremendous natural gas supplies in the country, but because of stringent environmental rules and regulations, a lot of those areas have not been able to be tapped. Do you believe that we ought to take another look at going after those reserves that we have of natural gas in this country?

Mr. YATES. Yes, I do. I think all efforts should proceed with all speed, including the potential of gas supplies in California. I do not believe that the potential for gas production in California has been either fully identified, nor exploited. We hear the numbers, that there is a 50 to 60-year supply of natural gas in this country to meet demand. We think we would come to the conclusion that there is plenty of gas; it is a matter of getting to it, to satisfy our needs.

Mr. BURTON. And through your research, have you found that could be garnered in an environmentally safe way?

Mr. YATES. I believe that is very possible.

Mr. BURTON. Thank you. Mr. Uhler, you said that the purchasers who are having a difficult time need to be able to have direct access to the supply of electricity. They cannot do that now because of State regulation?

Mr. UHLER. Well, what happened, Congressman, was when the regulation plan was first implemented some commercial users were given the opportunity for direct access. But meaningful direct access to residential users was denied because of the cost or rate structure imposed by the Public Utility Commission. So, while Enron Commonwealth, many others came in and sought to market their energy directly to the homeowner, much in the same way AT&T, Sprint, and everybody else entered in longline competition, because of the imposed rate control. A very small percentage of the people actually signed up. When AB1X passed in January here in the State, direct access was foreclosed for all users.

Mr. BURTON. Why was that? Why did they do that?

Mr. UHLER. It beats me. What happened here in California in kind of a global sense is, when the crisis arose and we had an opportunity to use market principles and buy long term the apparent mental state and outlook of the political leadership of this State, being essentially central planners, opted for a command economy approach.

Mr. BURTON. I understand.

Mr. UHLER. And decided to take over and run the thing their way.

Mr. BURTON. I understand. You said that earlier.

Mr. UHLER. Yes.

Mr. BURTON. Do you think that should be changed so that homeowners have——

Mr. UHLER. It absolutely must be changed. And I can only say that one of the things that is so distressing, in yesterday's announcement about the deal with Southern California Edison, was that, one of the things taken off the table was future development of hydroelectric properties owned by Southern California Edison. This is further evidence that this State administration will not confront the hardliners in the environmental community here in California and "go for it" in terms of relaxing the rules that will help our food processors and our dairy people and help everybody. Unshackle us. Our hands are tied.

Mr. BURTON. I can see——

Mr. UHLER. Let us out! Let us have direct access and we will make our own deals.

Mr. BURTON. I can see your enthusiasm, and you were getting into my next question. And that is——

[Applause.]

Mr. BURTON. Is that a relative of yours back there?

Mr. UHLER. No, we brought no relatives here this morning, Congressman.

Mr. BURTON. Well, you have some supporters. Let me just ask you this. And you were touching on this as I interrupted you there, and I apologize. You said an increase in production of the supply of energy by relaxing some of the clean air rules, at least for a period of time I guess is what you were saying. Over the long haul, you are for strong environmental standards, though?

Mr. UHLER. Yes. Whether these are good or bad is for the future.

Mr. BURTON. But you are talking about in the short run?

Mr. UHLER. I am talking about in the short run.

Mr. BURTON. OK. Let me follow——

Mr. UHLER. Both the Federal clean air——

Mr. BURTON. [continuing]. Let me followup. And we can look at that at the Federal level. But in the long run—and I will address this question to all three of you. I see my time is running out. Do you believe that an adequate supply of energy can be produced here in California and this region in an environmentally safe way, so that even though the rules might be relaxed in the short run, if there are proper free market principles installed, that we would be able to have an adequate amount of energy created to take care of the needs in California in an environmentally safe way?

Mr. UHLER. There is not even the slightest question. We could turn to nuclear. We know France now produces 75 percent of its domestic electricity through nuclear plants, and does it safely. This terror on the part of some environmentalists about nuclear is misplaced. We should reopen some nuclear plants that have been moth-balled, if we can do it quickly and properly. And hydro is of course the cleanest and safest, and also conserves our water, which is the next infrastructure problem the State faces.

Mr. BURTON. Thank you, Mr. Chairman.

Mr. OSE. If I might just offer one observation. It would help us to have yes or no or I do not know answers to questions. And then a very clear statement, and then do the expanding on the responses. So, Mr. Horn, for 10 minutes.

Mr. HORN. Just one to Mr. Uhler, the natural gas situation. We have got the natural gas. The question is, can we get it in the pipelines in the right places of the State. What do you know about the pipelines in northern California?

Mr. UHLER. I have no specific technical knowledge. I know they are trying to fill those pipelines with increased pressure at night to increase the storage that otherwise is unavailable. But beyond that, I do not have the technical knowledge.

Mr. HORN. Mr. Chairman, I would like to get the appropriate group that represents natural gas, to get those answers to this part of the State, and to the degree to which they clean the pipes, as you say, and they put other things through there. But let us get it at this point in the record, if I might.

Mr. OSE. Without objection.

Mr. HORN. No. 2. Mr. Yates, it is truly amazing the 100 percentages you have with pears and apricots and strawberries and peaches. We have got another problem, and that is what is gone at the roots of some of those. And I just wondered if you know off the top of your head the degree to which those trees are dying, and do you happen to have any information on that?

Mr. YATES. Pardon me? What specific crop are you referring to?

Mr. HORN. Well, in terms of the roots with the peaches, the grapes, so forth.

Mr. YATES. Oh, the disease in the grape community?

Mr. HORN. Exactly.

Mr. YATES. That is a huge problem. It is creating some shifts in producing areas, severe economic losses, and those sorts of things.

Mr. HORN. Mr. Chairman, I would like that put in the record at this point.

Mr. OSE. Without objection.

Mr. HORN. Thank you. I yield back to questions.

Mr. OSE. The gentleman yields back. If I might followup on a couple of things. Mr. Verboom, you are moving your dairy from San Diego County to Glenn County?

Mr. VERBOOM. Yes.

Mr. OSE. I know you do not ask a cattleman how many head he has, but you have a production of how many truckloads per day?

Mr. VERBOOM. We produce one truckload of milk per day.

Mr. OSE. OK. And, how many people work at your dairy?

Mr. VERBOOM. At home we have 11. On the new facility we will have about 18.

Mr. OSE. OK. If you cannot get power and you have to dump your milk, or you cannot plan with any degree of certainty, what happens to those jobs?

Mr. VERBOOM. Well, the cows have to be milked and fed. There is no getting around it. So, like I said, we have backup facilities. But being able to ship the milk to the plant has been the problem.

Mr. OSE. How long can you warehouse the milk on your dairy?

Mr. VERBOOM. One day.

Mr. OSE. So you have a 1-day window——

Mr. VERBOOM. Yes.

Mr. OSE [continuing]. To hold the milk before you have to move it?

Mr. VERBOOM. Yes.

Mr. OSE. And, if I understand correctly, it is the Gonzalez Milk Pool pricing system that governs what you get for your product?

Mr. VERBOOM. Yes.

Mr. OSE. So you and hundreds, if not thousands, of other dairy milkers have this same exact problem. You have a 24-hour window in which you have to move product from the farm to the processing plant. And, if they cannot handle it at the processing plant, you lose——

Mr. VERBOOM. It stays at the dairy if they cannot take it. It stays.

Mr. OSE. You lose the revenue that would come from the milk?

Mr. VERBOOM. Yes, definitely.

Mr. OSE. Or the cheese or the butter or what-have-you?

Mr. VERBOOM. Right. We get paid for the raw product and we would lose that money from that raw product.

Mr. OSE. How quickly does the unemployment or the economic chain reach the people who work for you?

Mr. VERBOOM. Well, it has not gotten to that point, but if it did, everybody would be out of work. Because if it came to the point where we could not get paid for our product, we would have to close it down.

Mr. OSE. OK.

Mr. VERBOOM. And it does not take long at a tanker load of milk a day.

Mr. OSE. Mr. Yates, in the food processing business, one of the standards you have to meet deals with food quality, the ability to ensure that the processing system is clean or clear of disease or infections and what-have-you, is that correct?

Mr. YATES. Absolutely, yes.

Mr. OSE. All right. So the FDA works with you and the California Department of Food and Agriculture works with you just to make sure that the product coming out of the plants that your members run is fit for human consumption?

Mr. YATES. It is safe and wholesome; yes.

Mr. OSE. To the extent that you have an interruption and a—let us say Campbell's Food Plant down here in south Sacramento, let us say they lose power. They have a co-generator, so they are probably not going to go down. But let us say they lose power. To the extent that they have lost power, just give me some sense of the impact on jobs at the plant and the farm that feeds the plant.

Mr. YATES. Let us take, for example, a tomato—back to a tomato processing facility. Delivery of tomatoes to a tomato processing facility is a tightly orchestrated and scheduled endeavor. Typically, a load of tomatoes is at the plant no longer than 3 hours. In other words, from harvest to being stabilized is, on average, about 3 hours. Now, if that plant is down for 24 to 36 hours, first they have vessels filled with 20,000 to 40,000 pounds of tomato product. As soon as power is lost, the aseptic or the sterility of that system is lost. That food, thousands of pounds of it, have to be emptied out when the power comes back on, because they have no power to get it out. Then that entire system has to be sterilized again. And then they have to start the plant up in a sterile condition.

In the meantime, during that 24 to 36 hours, there are crops in the field that are not going to get harvested because of the tight schedule of harvest and delivery. It is going to—as your question suggests, it is going to back up clear out to the field.

More importantly, and I will go to the natural gas situation, let us say a plant is shut down for a week. Tomato processing is highly seasonal. There is approximately a million tons a week that would not get processed. That is nominally $50 million that growers would not be paid. The energy it took to grow that crop, water pumping and so forth, would be lost. There would be a week worth of wages lost by food processing employees. Remember, this is an enterprise that is relatively short, 3 months, so many of those workers depend upon working every day during the season. That is a week's worth of wages lost. That is significant to those folks.

On top of it, the California food processor would not have product to satisfy its customer's needs, and that product will likely be furnished by Chile, Italy, Greece, or some other of our global competitors, because we do work in a global marketplace.

Mr. HORN. Mr. Chairman, if you will yield for a question.

Mr. OSE. Certainly.

Mr. HORN. Mr. Yates, I learned about 2 weeks ago that the last sugar beet processor had been closed. Is that true, and how difficult is that? And was there any effect of electricity in it?

Mr. YATES. That is my understanding, that the last one is gone. I do not believe that electricity was the cause of that. Sugar beet processing is a refining process. It is very energy-intensive, natural gas dependent. There were a number of other factors that have come to bear on the sugar beet industry in California, and if you want elaboration, I would be happy to provide it to you.

We are—if they were in business, the Public Utilities Commission has proposed on-peak rates for electricity to raise by 545 percent, an increase of 30 cents per kilowatt hour. We simply cannot operate on that basis. We cannot shut down during those peak times, and it presents an extreme challenge of how we are going to cope with that kind of an outcome.

Mr. OSE. I want to follow——

Mr. HORN. I might add on the sugar, if you could provide something for the record, I grew up on a farm 17 miles from Spreckles Processing Plant in Salinas.

Mr. YATES. I will certainly do that. The sugar beet industry in California, as you know, in years past was very vigorous and it provided a lot of jobs. It is very unfortunate that they are no longer in business in California.

Mr. OSE. Mr. Yates, some of the suggestions that we have heard have to do with shifting load from say mid-afternoon to overnight. My understanding, during harvest season, is that your members are running their plants 24-hours a day; is that accurate?

Mr. YATES. That is correct.

Mr. OSE. So shifting load is pointless.

Mr. YATES. Shifting load is a very challenging prospect. Remember, and I am trying not to repeat, we are processing a huge volume of food that is harvested ripe for a very short period of time. So in order to get it all stabilized, they are running 24 hours a day. Of course, there are periods of shutdown for cleanup. I mean, it is just like your kitchen. You got to stop once in a while and clean it up.

We have advanced and are advancing a proposal to shrink that peak period of time for perishable food processors. Go ahead and double the price for that time, but at least give us a better opportunity to avoid that high-price period. And we think there is a number of food processors that might be able to work out a deal with their labor force, with their growers, with their truckers, and everyone else that is dealing with getting all this food processed. At least we would certainly like to have that opportunity.

Mr. OSE. I need to ask one other question. I want to go to Mr. Uhler on this. The State of California has been put on watch by Moody's as a result of the implications of the energy crisis we face. In a very real sense, it is my understanding that in the financial markets that will cause an increase in the bonding cost to the State of California. In other words, there will be a premium attached to bonds from the State of California to reflect that added risk. Am I understanding that correctly? What are the implications for the provision of government services?

Mr. UHLER. You are understanding that correctly, and that will increase the cost of all the bonded indebtedness for the State. Apparently there is some question as to whether the markets can receive and absorb the level of revenue bonds, which are proposed to meet this electricity problem, and do so effectively. It is really riling up the bond situation for the State of California and for our taxpayers.

Mr. OSE. My time has expired. I want to go back to Chairman Burton for a followup.

Mr. BURTON. I have a number of questions that I would like for you to answer as concisely as you can, because I want to have them for the record. The Governor is not releasing the figures that the State is paying for electricity. Is that information that taxpayers want to have and should have?

Mr. UHLER. Correct. And in our written testimony we have asked for that, and numbers of individuals and members of the media have asked, and that has not been forthcoming.

Mr. BURTON. Has the Governor given a reason why that has not been publicized?

Mr. UHLER. The stated public reason is that this will interfere with confidential negotiations for future power purchase contracts.

But it seems to us that, since he is obligating taxpayers, the taxpayers have a right to know to what degree and in what direction.

Mr. BURTON. Thank you. Let me run through these questions rapidly here, and if you could answer them. In your testimony, Mr. Yates, you talk about the problems that processors will face in the event of a blackout. What actions is the food processing industry taking to try and cope with the predicted blackouts? You have talked about scheduling a little bit and the difficulty, but what alternative fuels are you looking at, if any? And so if you could answer that.

Mr. YATES. Thank you. We are doing a couple of things. We were working with our legislatures and the administration to pave the way for food processors and others to utilize backup generation during a blackout period. That has been achieved.

Mr. BURTON. What alternative fuels are you going to be using, please?

Mr. YATES. Propane for firing boilers. The other thing we are doing, and the industry, since this has not been a problem in the past, does not have—there is only about 5 to 7 percent of the industry that has backup generation. And this is backup generation that does not satisfy the entire electric requirements of the facility. It is minimal, it is enough to keep computers going, the control room going, and those sorts of things. So lights on for employee safety and those sorts of things. And the industry is—a number of food processors are looking at acquiring backup generation. Very few are looking at enough backup generation to run the entire facility. That is just too much.

Mr. BURTON. And the only other alternative fuel you mentioned there was liquified gas.

Mr. YATES. That is one of the options. Diesel is another one. And I hasten to add——

Mr. BURTON. That is an EPA problem.

Mr. YATES [continuing]. That both of those have limits. They have emission limits. We are not asking that those be eased. But we are asking eventually, let us comply with the offset requirements, give us some more time to do that, because it is practically impossible to do it in the time necessary for this summer processing season.

Mr. BURTON. In terms of using alternatives such as diesel, oil, or propane, the regulatory barriers that you are facing, as you just mentioned, are difficult, but you do not want them relaxed, you just want them to be offset?

Mr. YATES. In our case, yes.

Mr. BURTON. In other areas, do they need to be relaxed? I mean, I know that in food processing—in the other areas, do you need to have a relaxation for a short period of time, either one of you?

Mr. UHLER. Well, you know, I stated to the Congressman earlier that——

Mr. BURTON. I know you have stated, but do you have any facts that shows that there should be a relaxation of those EPA rules?

Mr. UHLER. Well, only by empirical evidence of the shutdown of perfectly capable generators that have run out of hours. This is all arbitrary and artificial. To have people sit in the dark in their homes or in their factories in July because a local air quality management control district has arbitrarily shut down a generator is, in my judgment, absurd.

Mr. BURTON. I think I want—go ahead.

Mr. HORN. Could I just ask one that fits on your question?

Mr. BURTON. Yes. I yield.

Mr. HORN. As I drove into Sacramento this morning, I wondered, by seeing the sign over it, there is a fuel cell technology movement going. And to what degree could that be helpful, or is it—does not do enough?

Mr. UHLER. You know, again, I have done only the normal reading on that, and there seem to be tremendous advances in fuel cells. Once that technology is refined, people can have that running their home or their business or whatever, but that is not going to solve this summer's problem and maybe not next.

Mr. HORN. Mr. Chairman, if we could get a presentation from the fuel cell technology people as to where they are on this and what they can do.

Mr. BURTON. Since the State has begun purchasing electricity, your testimony, Mr. Uhler, notes that Wall Street has reacted negatively. How would a downgraded bond rating affect the budget of California, and does it negatively affect other programs that rely on the State to issue bonds?

Mr. UHLER. Well, in driving up the interest cost on the bonded indebtedness, of course, that will harm the State. We have had huge surpluses which the State has spent over the last couple of years. The predicted surplus for the next year is probably ephemeral. We are probably eating into the money for actual programs at this point, but because of the secrecy and the lid imposed by the Governor's office, we do not know the specific details.

Mr. BURTON. OK, let me just ask a couple more questions.

Mr. OSE. Mr. Chairman, Mr. Yates has something.

Mr. YATES. Mr. Burton, may I clarify further your earlier question about alternative fuels. My response was relative to fuels to operate boilers. When it comes to the issue of utilizing diesel generators for electricity, there is, in my opinion, a number of arbitrary decisions that have been made. For example, there is 5,000 megawatts—it is my understanding there is 5,000 megawatts of emergency backup generation setting around the State, and the State refuses to turn it loose, but instead takes their chances on rolling blackouts.

Mr. BURTON. Why are they—is it because of environmental concerns that they are refusing to turn that loose?

Mr. YATES. That is my understanding. And our——

Mr. BURTON. And there is 5,000 megawatts, you say?

Mr. YATES. That is my understanding; yes.

Mr. OSE. Mr. Chairman, would you yield for a minute?

Mr. BURTON. I would be happy to yield.

Mr. OSE. Mr. Yates, 5,000 megawatts is a lot of megawatts. Hearing that anecdotally is one thing, seeing a list is another. Do you have a list?

Mr. YATES. I believe we can obtain—a list I believe has been developed by the Air Resources Board. At least that is what has been represented to us by representatives from the California Resources Board, that there is 5,000 megawatts.

Mr. OSE. We need to get that list.

Mr. YATES. Now, modern backup generation——

Mr. BURTON. Who would have that list?

Mr. OSE. Mr. Yates just said the Air Resources Board here in the State of California is the source of that list, source of that information.

Mr. BURTON. Are they keeping that secret or are they not letting that out?

Mr. YATES. Not to my knowledge, no. And I believe the Governor's office has that kind of information.

Mr. OSE. Well, how do we get it?

Mr. BURTON. Well, I know how we can get it.

Mr. OSE. You are the chairman.

Mr. BURTON. Yes. We can take a hard look at how to get that information.

Mr. OSE. We will get that information. If you can tell us the name of the person who gave you that anecdotal information, we will be able to followup accordingly.

Mr. YATES. I will certainly provide that to you. Thank you. And one last comment relative to this scare, fear of diesel generation. A modern, one-megawatt portable generator puts out as much emissions, if you will, as three trucks rolling down the highway. So people are making a big bogeyman out of this, and they ought to be taking a harder look at it. Thank you.

Mr. BURTON. Let me just ask a couple more questions so I can get these for our record, Mr. Chairman. How much of a role do you believe Federal and State environmental regulations have in restricting the supply of electricity? I mean, how severe is the controls affecting the supply?

Mr. YATES. It is my observation, if I may, that all of the new power plants being proposed to be built in California are setting new records for cleanliness, not only in terms of their emissions, but their efficiency. They are so much more efficient, that the amount of emissions—not only are the emission limits very low, but the amount of emissions per megawatt are extremely low, and they are going to push out the old, dirty plants.

Mr. BURTON. Are they being held up for any reason since they meet the criteria that they should?

Mr. YATES. It is my understanding that the expedited processes at the California Energy Commission, who is responsible for siting those, is proceeding at the high levels as expected.

Mr. BURTON. OK.

Mr. UHLER. If I may add, Mr. Chairman, one of the things that we have recommended, and that the Governor has within his emergency powers, is to make the decision of the California Energy Commission binding, with respect to the siting of any particular plant, irrespective of local land use controls. And he ought to do that, because we now have problems at the local level, the NIMBY problem, "not in my back yard." And yet we need to site those plants close to the user base, given the antiquated nature of our transmission system, and to expedite that process before the California Energy Commission.

Mr. BURTON. Mr. Chairman, I have a few questions I would like to submit for the record for Mr. Verboom on the dairy products, but if we could get those to him and he can just answer them.

Mr. OSE. Without objection.

Mr. BURTON. Thank you.

Mr. OSE. Mr. Chairman, just for your information, I want to go back to Mr. Yates. Current California Energy Commission requirements are that a generating facility in excess of 50 megawatts must come before the Commission for review. I know that Assemblyman Cox has a legislative proposal that would raise that threshold from 50 to 125 megawatts as the threshold. The reason is that the technology for these turbines typically creates a turbine of 60 megawatts capacity. So, the 50 megawatt threshold is kind of pointless, because everything has to go. If we could get that to move forward, we would have a lot of these standby generators doubling their capacity without having to go through a lengthy review process. We will put that in the record.

Mr. Horn, anything else?

Mr. HORN. When you ask for that figure, I would like to see it broken down in terms of hospitals, which already have generators, and then try to get it in the rest of the economy, agriculture.

Mr. OSE. You are talking about the 5,000 megawatts list?

Mr. HORN. Exactly, yes.

Mr. OSE. All right.

I want to thank these witnesses for joining us today. Your information has been solid, and I appreciate you taking the time.

Mr. UHLER. Thank you.

Mr. YATES. Thank you.

Mr. VERBOOM. Thank you.

Mr. OSE. OK, we are going to go ahead and call up the next panel, and that would be Mr. Kevin Madden, Mrs. Loretta Lynch, Mr. Terry Winter and Mr. Larry Makovich.

OK, if the witnesses would rise, please.

[Witnesses sworn.]

Mr. OSE. Let the record show the witnesses answered in the affirmative.

Joining us on this panel, we will just move from my left to the right. The first witness is Mr. Kevin Madden, who is the general counsel for the Federal Energy Regulatory Commission. Mr. Madden, you are recognized for a 5-minute statement.

STATEMENTS OF KEVIN P. MADDEN, GENERAL COUNSEL, FEDERAL ENERGY REGULATORY COMMISSION; LORETTA LYNCH, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION; TERRY W. WINTER, PRESIDENT AND CEO, CALIFORNIA INDEPENDENT SYSTEM OPERATOR; AND LARRY MAKOVICH, SENIOR DIRECTOR, CAMBRIDGE ENERGY RESEARCH ASSOCIATES

Mr. MADDEN. Thank you, Mr. Chairman. I thank the committee and subcommittee for the opportunity to discuss the topic of electricity markets in California and surrounding States. As Mr. Chairman said, I am Kevin P. Madden. I am the general counsel of the Federal Energy Regulatory Commission. I appear today as a Commission staff witness, and I do not speak on behalf of the Commission.

Electricity markets in California and throughout much of the West are in a state of stress, and they will continue to experience various serious problems throughout the coming summer. Wholesale prices have increased substantially. Consumers are being implored to conserve as much as possible, and utilities continue to face severe financial problems. PG&E has just filed for reorganization under Chapter 11 of the U.S. bankruptcy code last week.

The Commission has aggressively been identifying and implementing market-driven solutions to the problems. Let me just highlight some of the recent actions we have taken to address these problems. Earlier this month, the Commission took strong action to mitigate prices in California's electricity markets for the periods of January and February. The Commission identified many transactions during these 2 months that warranted further investigation. The Commission required the sellers to either refund certain amounts or to offset those amounts against what is already owed them. They also require them to provide any additional information which they believe could justify their particular rates. The total amount of potential refunds for just those 2 months, January and February, amounted to $124 million.

Also in March, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and in the West. The Commission implemented certain measures immediately. These include extending and broadening waivers for certain facilities under PURPA, enabling those facilities to generate more electricity without the restrictions that they usually have. We expedited the certification of natural gas pipelines into California and the West. Just this week, the Commission authorized Kern River Pipeline to provide approximately 300 MCF per day additional capacity into southern California; this is expected to come online in June or July of this summer. We also urged all licensees to review the FERC licenses that they hold in order to assess the potential to increase the generating capacity at those particular projects.

The Commission also proposed and sought comment on what other measures it should employ to assess rates for transmission facilities and for natural gas facilities in order for them to be online to provide energy this summer.

Finally, the Commission announced a 1-day conference with State commissioners and other State representatives from Western States to discuss the volatility of the price in the Western United States, as well as other issues needed to address those particular prices; infrastructure, for example. The conference is being held today in Boise, ID.

On March 14th, the Commission ordered two utilities to justify the duration of the outages in 2000, April and May 2000, at their California generating facilities. Those outages forced the California ISO to purchase more expensive power from the utilities for the generating facilities. Absent adequate justification, the utilities must make refunds in the amount of $10.8 million.

On March 28th, the Commission also addressed a complaint filed by the California Public Utility Commission under section 5 of the

Natural Gas Act against a pipeline company and its marketing affiliate. While FERC found one part of the complaint unsupported, FERC ordered a hearing on whether the pipeline and its affiliate had market power; and if so, used that market power to drive up the prices of natural gas at the California border. The case is now pending before an administrative law judge. The Commission set this case on a fast track and a decision is due back to the Commission in 60 days.

Finally, the Commission's staff, at the Commission's direction, has proposed a market monitoring and mitigation plan for California. This would require all sellers with uncommitted power to sell in the real-time market. The Commission is currently considering comments on this proposal filed by numerous entities, and expects to act on this in the near future for the summer.

These actions, I believe, demonstrate the Commission's commitment to take all appropriate action to remedy the current imbalances in western energy markets. While some have accused the Federal Energy Regulatory Commission of being indifferent or even hostile to the concerns of California consumers, our actions prove otherwise. It is not true. We have pursued the remedies we believe will be most effective, not only in the short term, but also in the long term. No one should doubt our commitment to ensuring an adequate supply of energy for all consumers at reasonable prices.

By itself, however, the Commission cannot contribute all. It can only contribute a small part of the solution to today's energy problems. A more comprehensive and permanent solution requires the involvement of the States and other Federal agencies and departments. In particular, California must do as much as possible to expedite the construction of newer power plants. I am encouraged by all the hard work and effort taken in recent months, but——

Mr. OSE. Mr. Madden, are you about done?

Mr. MADDEN. I am about done.

Mr. OSE. Your time is about up here, so you need to wrap up.

Mr. MADDEN. I am encouraged by the action taken by the State of California and the other States, but we must be vigilant to ensure that these new facilities are built.

Mr. Chairman, I will be happy to answer any questions. Thank you.

Mr. OSE. Thank you.

Our next witness is Ms. Loretta Lynch, who is the president of the California Public Utilities Commission. Ms. Lynch, you are recognized for 5 minutes.

[The prepared statement of Mr. Madden follows:]

Summary of Testimony of
Curt L. Hébert, Jr., Chairman
Kevin P. Madden, General Counsel
Federal Energy Regulatory Commission
Before the Committee on Government Reform
United States House of Representatives
April 10-12, 2001

Wholesale and retail electricity markets in California and throughout much of the West are in a state of stress, and they will continue to experience very serious problems throughout the coming summer. Wholesale prices have increased substantially for a variety of reasons, consumers are being implored to conserve as much as possible, and utilities continue to face severe financial problems. Pacific Gas & Electric Company has now filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. As a result of California's market dysfunctions and their impact in the West, many now argue that we need to return to cost-based regulation, instead of relying on market-driven solutions.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices send the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices below market levels through regulation or legislation will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Federal Energy Regulatory Commission has been aggressively identifying and implementing market-driven solutions to the problems: (1) by stabilizing wholesale energy markets; (2) by adopting or proposing additional short-term and long-term measures that will increase supply and delivery infrastructure, as well as decrease demand; (3) by promoting the development of a West-wide regional transmission organization; and, (4) by monitoring market prices and market conditions.

Other regions that have not adopted California-type restrictions on electricity competition have demonstrated that consumers can and do gain from electricity competition and restructuring. California and Western consumers similarly can share in these gains, once market rules are in place that will make California and other Western states an attractive place for investment.

Testimony of
Curt L. Hébert, Jr., Chairman
Kevin P. Madden, General Counsel
Federal Energy Regulatory Commission
Before the Committee on Government Reform
United States House of Representatives
April 10-12, 2001

I. Overview

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear here today to discuss the topic of electricity markets in California. As we all convene here today, we are keenly aware that wholesale and retail electricity markets in California and throughout much of the West are in a state of stress and that these markets will continue to experience very serious problems throughout the coming summer. Wholesale prices for electricity have increased substantially for a variety of reasons in the last year. California power consumers are being implored to conserve. California load-serving utilities continue to face severe financial problems, and one of those utilities, Pacific Gas & Electric Company, has filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. And companies supplying wholesale power into California are unsure how much, or even whether, they will be paid for their supplies.

While the situation in California is not representative of other parts of the country that are successfully developing competitive markets, it nevertheless underscores the fundamental infrastructure problems facing the country. The demand for electricity continues to expand while supply fails to keep pace. The development and licensing of new hydroelectric capacity – which provides much of the existing power supply in the West – is nearly exhausted. Very little fossil-fired generation has been added in many regions of the country over the last few years, and in California no major plants have been added in the last decade. And the existing electric transmission grid is often fully loaded and, absent necessary expansion, is often incapable of delivering power to those regions where it is valued the most.

I would like to make three main points with respect to these problems and to identify the steps the Commission is taking to address these problems.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices send the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices below market levels will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. California is not an island. It depends on generation from outside the State. The shortages and the prices in California have affected the supply and prices in the rest of the West. The Western transmission system is an integrated grid, and buyers and sellers need non-discriminatory access to all transmission facilities in the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Commission continues aggressively to identify and implement solutions to the problems:

- **First**, in recent months, the Commission has issued a number of orders intended to restore market stability. The Commission has acted to move utilities out of volatile spot markets to enable them to develop a portfolio of risk reducing and creditworthy contracts that will reduce price risks.

- **Second**, the Commission has recently adopted or proposed a range of additional measures that will increase supply and delivery infrastructure, as well as reduce demand for electricity in the Western Interconnection.

- **Third**, the Commission is continuing to work with market participants on developing, as quickly as possible, a West-wide regional transmission organization. Such an organization will bring a regional perspective and offer regional solutions to regional problems.

- **Fourth**, the Commission is monitoring market prices and market conditions with the goal of ensuring long-term confidence in Western markets. Moreover, the Commission's staff has proposed a new plan to monitor and, when appropriate, mitigate the price of electric energy sold in California's spot markets on a before-the-fact basis, instead of addressing prices through after-the-fact refunds. The Commission expects to act on this proposal by May 1, 2001.

By itself, however, the Commission can contribute only a small part of the solution to today's energy problems. A more comprehensive and permanent solution requires the involvement of the states and other federal agencies and departments. I am encouraged by all of the hard work and effort undertaken in recent months by the State of California and other Western states. The issues are difficult and the stakes are high. While reasonable minds can differ over the appropriate solutions to these problems, the Commission is committed to resolving these problems deliberatively.

An attachment to my testimony provides details on the Commission's actions concerning California's electricity markets in recent months.

II. What Went Wrong Here?

A. Legislative Design

The State of California has been widely questioned for its restructuring legislation (AB 1890), unanimously enacted in 1996. While mistakes were made, California is to be commended for realizing that consumers are better off if supply and pricing decisions are based on market mechanisms, not bureaucratic fiat. The premise of this legislation was that consumers would enjoy lower rates and increased service options, without compromising reliability of service, if electricity providers could be motivated to serve by market forces and competitive opportunities.

The major features of AB 1890 included: (1) creation of an independent system operator (ISO) and power exchange (PX) by January 1998 and simultaneous authorization of retail competition; (2) creation of the California Electricity Oversight Board with members appointed by the Governor and legislature; (3) a competitive transition charge for the recovery of the traditional utilities' stranded costs; and (4) a ten percent rate reduction for residential and small customers, and a rate freeze for all retail customers.

There were two major flaws in California's market design. First, the three utilities were forced to buy and sell power exclusively through the spot markets of the PX. This prevented the utilities from hedging their risks by developing a portfolio of short-term and long-term energy products. Second, the State-mandated retail rate reduction and freeze eliminated any incentives for demand reduction, discouraged entry by competitors for retail sales and, more recently, has threatened the financial health of the three investor-owned, load serving utilities by delaying or denying their recovery of billions of dollars in costs incurred to provide service to retail customers.

However, California's situation does not demonstrate the failure of electricity competition. To the contrary, it demonstrates the need to embrace competition fully, instead of tentatively. Other states, such as Pennsylvania, have been successful in implementing electricity competition. California needs to move forward on the competitive path it has chosen, allow new generation and transmission to be sited and built, and allow its citizens to benefit from the lower rates, higher reliability, and wider variety of service options that a truly competitive marketplace can provide.

B. Other Factors

Until last year, California's spot market prices were substantially lower than even California's mandated rate freeze level. This allowed the California investor-owned utilities to pay down billions of dollars of costs incurred during cost-of-service regulation. However, several events resulted in higher spot electricity prices beginning last summer. Those events included one of the hottest summers and driest years in history, as well as several years of unexpectedly strong load growth. Other factors that have recently influenced prices include:

o unusually cold temperatures in early winter in the West and Northwest;

- California generation was unavailable to supply normal winter exports to the Northwest;
- very little generation was added in the West, particularly in California, Washington and Oregon, during the last decade;
- environmental restrictions limited the full use of power resources in the region;
- scheduled and unscheduled outages, particularly at old and inefficient generating units, removed large amounts of capacity from service; and
- natural gas prices increased significantly, due to higher commodity prices, increased gas demand, low storage, and constraints on the delivery system.

Taken together, these factors demonstrate that the present problems in electricity markets are not just "California" problems. Normal export and import patterns throughout the West have been disrupted. Reserve margins throughout the West are shrinking. This winter, when the demand for electricity was relatively low, Stage Three emergencies in California were commonplace.

III. The Commission's Role in California's Restructuring

A. Start-up and Early Problems

The Commission began addressing the California restructuring in 1996. Initially, the Commission's approach was largely deferential to State decisions affecting wholesale power market matters within FERC's jurisdiction. However, as problems started surfacing and then heightened significantly in the Summer of 2000, the Commission found that it could no longer defer to State decisions affecting matters within the Commission's jurisdiction. The resources devoted by the Commission to California's restructuring were significant from the beginning and, in recent months, have increased substantially.

In 1996 and 1997, the Commission approved, with limited exceptions, the jurisdictional aspects of the California restructuring as proposed. The Commission authorized the transfer of operational control of transmission facilities from Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SoCal Ed), and San Diego Gas and Electric Company (SDG&E) (collectively, the California IOUs) to the ISO. The Commission also authorized the ISO and PX to commence operations.

Shortly after the ISO and PX commenced operations on March 31, 1998, prices for ancillary services (e.g., spinning reserves) in the ISO's markets increased significantly. The ISO proposed purchase price caps as a solution. In response, the Commission authorized the ISO for an interim period to reject bids in excess of whatever prices the ISO believed were appropriate for the ancillary services it procured. The Commission stated, however, that a purchase price cap is not an ideal approach to operating a market and that it did not expect the cap to remain in place on a long-term basis. The Commission later approved an ISO filing seeking authorization for a similar purchase price cap for an additional ISO-operated market (imbalance energy).

Subsequently, the Commission authorized the ISO to continue specifying purchase price caps for ancillary services and imbalance energy until November 15, 1999. The Commission said the ISO could file for another extension of its price cap authority if serious market design flaws still existed. In late 1999, the ISO filed to extend the purchase price cap. The Commission permitted a purchase price cap of $250 to remain in effect from

August 7 until December 8, 2001. (Buyer caps of $750, then $500, had been in effect prior to that time.)

B. Actions Taken Last Year

Last summer, bulk power prices in California began increasing significantly. (Other parts of the country also experienced price spikes then, but outside of the West prices generally subsided later in the year.) As the problems in California's bulk power markets mounted, the Commission realized that its policy of deference had not worked as intended, and that the Commission needed to take more of a leadership role in addressing the problems.

On July 26, 2000, the Commission ordered a staff fact-finding investigation on technical or operational factors, regulatory prohibitions or rules (Federal or State), market or behavioral rules, or other factors affecting the competitive pricing of electric energy or the reliability of service in electric bulk power markets. The Commission directed its staff to report its findings to the Commission by November 1, 2000.

In August 2000, the Commission issued an order initiating a formal hearing under Section 206 of the Federal Power Act (FPA) on the rates of public utilities that sell in California's spot markets. This action meant that refunds could be ordered as of the earliest possible refund effective date under Section 206 -- October 2, 2000 -- if rates were found to be unjust and unreasonable. The Commission on its own motion also ordered an investigation into whether the tariffs and institutional structures and bylaws of the California

ISO and PX were adversely affecting the efficient operation of competitive wholesale electric power markets in California and needed to be modified.

On November 1, 2000, upon completion of the Commission staff study of bulk power markets, the Commission found that:

> the electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy (Day-Ahead, Day-of, Ancillary Services and real-time energy sales) under certain conditions.

93 FERC ¶ 61,121 at 61,349-50 (2000). To fulfill its duty under the FPA, the Commission then proposed a number of remedies "to establish market rules, regulations and practices that will ensure just and reasonable rates in the future." Id., at 61,350. The Commission allowed an opportunity for public comment on its proposed remedies, and held a technical conference with affected parties, including California state officials.

In an order issued on December 15, 2000, the Commission adopted a series of remedial measures designed to stabilize wholesale electricity markets in California and to correct wholesale market dysfunctions. The Commission recognized that the primary flaw in the California market design was the requirement for the California IOUs to buy and sell solely in spot markets. The Commission removed this requirement from the wholesale tariff to allow the utilities, first, to use their own remaining generation resources to meet demands at state-regulated prices and, second, to help them meet much of their remaining needs for power through forward contract purchases. Our action returned to California the ability to regulate about one-half of the California IOUs' peak load requirements. The Commission also ordered the termination of the PX's wholesale rate schedules effective as of April 30, 2001.

In addition, the order addressed the problem of underscheduling, directing utilities to arrange 95 percent of their transactions before real-time, to reduce the reliance on the ISO's real-time market. A penalty would be imposed for utilities that did not comply.

The order also established a $150 per MWh breakpoint mechanism as part of a rate monitoring and mitigation plan from January 1, 2001 until May 1, 2001, when the Commission expects to put in place long-term measures. The ISO's rules were modified so that bids above $150 per MWh would not set the market clearing prices paid to all bidders. Public utility sellers (primarily the investor-owned utilities) that bid above this breakpoint were required to file weekly transaction reports with the Commission. Sellers were made liable for refunds if the Commission finds they sold power at prices that were not just and reasonable.

C. The Commission's Latest Efforts

Since the Commission's change in Chairmanship on January 22 of this year, the Commission has implemented a number of significant steps to address the problems in the California and Western energy markets, as summarized briefly below. (Many of the following matters are still pending before the Commission, so my remarks are limited to describing the actions taken without further addressing the merits.)

On January 29, 2001, the Commission issued an order finding the PX in violation of its December 15 order by not implementing the $150 per MWh breakpoint mechanism, and it required immediate recalculation of wholesale rates by the PX. The Commission stated that the PX's violation was costing electricity consumers substantial amounts of money. The Commission cited an estimate by PG&E that the cost of the PX's violation for just one day in early January was over $20 million.

On February 14, 2001, the Commission addressed tariff revisions proposed by the ISO and PX to lower their creditworthiness requirements. At the time, the credit ratings of PG&E and SoCal Ed had deteriorated significantly, making them unable to meet the existing requirements. The Commission accepted the ISO's amendment to the extent of allowing PG&E and SoCal Edison to continue using their own generating resources to serve their own load. The Commission held, however, that the utilities could continue buying through the ISO from third-party suppliers <u>only</u> if they obtained adequate financial backing from others (such as the California Department of Water Resources). The Commission found this result necessary to prevent price increases to consumers because suppliers would otherwise raise their prices to compensate for the utilities' credit risk. (The Commission noted that the PX had suspended operations of its spot markets and, thus, rejected the PX's filing.)

On March 9 and 16, 2001, the Commission took further steps to mitigate prices in California, specifically the prices charged in California's spot markets during Stage Three emergencies in January and February of this year. After examining prices charged in these periods, the Commission identified many transactions that warranted further investigation.

The Commission required these sellers to either refund certain amounts (or offset these amounts against amounts owed to them) or provide additional information justifying their prices. Specifically, the Commission required refunds or offsets of approximately $124 million. The Commission used a proxy price approach based on the market clearing price that would have occurred had the sellers bid their variable costs into a competitive single price auction.

On March 14, 2001, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and the West. The Commission implemented certain measures immediately, including: streamlining filing and notice requirements for various types of wholesale electric sales (including sales of backup or on-site generation and sales of demand reductions); extending (through December 31, 2001) and broadening regulatory waivers for qualifying facilities under the Public Utility Regulatory Policies Act of 1978, enabling those facilities to generate more electricity; expediting the certification of natural gas pipeline projects into California and the West; and, urging all licensees to review their FERC-licensed hydroelectric projects in order to assess the potential for increased generating capacity.

The Commission also proposed, and sought comment on, other measures such as incentive rates and accelerated depreciation for new transmission facilities and natural gas pipeline facilities completed by specified dates, blanket certificates authorizing construction of certain types of natural gas facilities, and allowing greater operating flexibility at hydroelectric projects to increase generation while protecting environmental resources.

Finally, the Commission stated its intent to hold a one-day conference with state commissioners and other state representatives from Western states to discuss price volatility in the West, as well other FERC-related issues recently identified by the Governors of Western States. The conference is being held in Boise, Idaho, on April 10.

Also on March 14, the Commission ordered two utilities to justify the duration of outages at their California generating facilities. The outages forced the ISO to purchase more expensive power from the utilities' other generating facilities. Absent adequate justification, the utilities must make refunds.

On March 28, 2001, the Commission addressed a complaint by the California Public Utilities Commission under section 5 of the Natural Gas Act against El Paso Natural Gas Company and its marketing affiliate. The California Commission asserted that certain contracts between the pipeline and its affiliate for firm pipeline capacity to California raised issues of possible affiliate abuse and anti-competitive impact on the delivered price of gas and the wholesale electric market in California. FERC found the allegations of affiliate abuse unjustified. However, the Commission ordered a hearing before an administrative law judge on whether El Paso and/or its marketing affiliate may have had market power and, if so, exercised it so as to drive up natural gas prices at the California border. The Commission directed the judge to provide the Commission with an initial decision within 60 days.

In sum, the foregoing efforts demonstrate the Commission's commitment to take all appropriate actions to remedy the current imbalances in Western energy markets. While some have accused the Commission of being indifferent or even hostile to the concerns of California consumers, the Commission's actions prove otherwise. We have pursued the remedies we believe will be most effective, not only in the short-term but also in the long-term. Others may disagree with our solutions, but no one should doubt the Commission's resolve to ensuring an adequate supply of energy for all consumers at reasonable prices.

IV. We Need A West-wide RTO

The development of a West-wide regional transmission organization (RTO) is vital to preventing future problems in the West. The shortages and prices in California have affected the supply and prices in states throughout the West because the Western transmission system is an integrated grid. A West-wide RTO is critical to support a stable interstate electricity market that will provide buyers and sellers the needed non-discriminatory access to all transmission facilities in the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

A West-wide RTO should be truly West-wide. It should include participation by both public utilities as well as non-public utility entities such as municipalities and cooperatives. To encourage the formation of a West-wide RTO, Congress may wish to consider the elimination of tax or other restrictions on public power and cooperative participation in RTOs. Congress may also wish to consider eliminating any impediments to participation by the Bonneville Power and Western Area Power Administrations in a West-wide RTO.

V. Possible Sale of Transmission Assets to the State of California

One step that has been considered as a way to address the financial problems of California's public utilities is for the State to purchase their transmission facilities. Such a transaction, in my view, would require the Commission's approval. Section 203 of the Federal Power Act requires Commission review of the transfer of ownership or operational control of jurisdictional transmission facilities owned by public utilities, when such facilities have a value exceeding $50,000. If this transaction occurs, the Commission would need to decide whether the transaction is consistent with the public interest, based on all relevant considerations.

VI. Price Caps Would Make Things Worse

Some advocate price caps or cost-based limitations as a temporary way to protect consumers until longer-term remedies alleviate the supply/demand imbalance. The issue of price caps in the West has been raised on rehearing of the Commission's order of December 15, 2000, and, accordingly, is pending before the Commission. For this reason, I cannot debate the specific merits of price caps for California or the West. However, I will reiterate briefly publicly stated views on this issue.

As a general matter, price caps do not promote long-term consumer welfare. Price caps will not increase energy supply and deliverability or decrease demand. Instead, price caps will deter supply and discourage conservation. At this critical time, legislators and regulators need to do everything they can to promote supply and conservation, not discourage them.

This viewpoint is based on experience, not just economic theory. The summer of 1998 illustrates the point. Then, wholesale electricity prices in the Midwest spiked up significantly. The Commission resisted pleas for immediate constraining action, such as price caps. Subsequently, suppliers responded to the market-driven price signals, and today the Midwest is not experiencing supply deficiencies.

In short, price caps can have long-term harmful effects because they do not provide appropriate price signals and may exacerbate supply deficiencies. Supply and demand cannot balance in the long-term if prices are capped.

In the context of California, today we have prices that reflect the fact that supplies are barely adequate. If we reduce prices, supplies will go elsewhere, risking greater reliability problems. Price caps will only aggravate the supply-demand imbalance.

In addition, capping prices based on individual seller costs likely would require lengthy, costly and contentious evidentiary hearings. Litigating such a rate case for one seller requires a significant commitment of resources. Concurrently litigating such cases for scores of sellers in the West would be overwhelming both for the Commission and the industry. Moreover, neither buyers nor sellers would be sure of the prices until the conclusion of this litigation. This delay in price certainty would be unfair to customers and discourage new investments by suppliers.

Many lead:.:s share these views. In a letter to the Secretary of Energy, dated February 6, 2001, eight Western governors expressed their opposition to regional price caps. They explained that "[t]hese caps will serve as a severe disincentive to those entities considering the construction of new electric generation, at precisely the time all of us – and particularly California – are in need of added plant construction."

In the face of the current challenges, we all must have an open mind to any proposals that may mitigate the energy problems in the West. With respect to proposals for a West-wide cap, however, several points must be considered. First, any effort by the Commission to impose a West-wide cap will miss the large part of the Western market that is beyond the Commission's jurisdiction, let alone the other domestic and international markets. Regulating only one part of a market is unlikely to help, as investors and suppliers will simply focus their efforts elsewhere. Second, the price caps used previously in California were administratively easy to implement because California (unlike other parts of the West) has a spot market managed by a jurisdictional public utility. Absent such a spot market, price caps are much more difficult to implement and monitor. Third, a West-wide price cap as proposed by some would abrogate all existing long-term contracts containing higher prices. Historically, the Commission generally has been reluctant to take such an action, preferring instead to honor the contractual commitments that parties voluntarily make.

VII. Conclusion

The Commission remains willing to work in a cooperative and constructive manner with other federal and state agencies. Both the federal government and state governments have critical roles to play in promoting additional energy supply and deliverability and decreasing demand. Through its authority to set rates for transmission and wholesale power and to regulate interstate natural gas pipelines and non-federal hydroelectric facilities in interstate commerce, the Commission can take a range of measures to promote a better balance of supply and demand, but its jurisdiction is limited. The Commission can set pricing policies which encourage entry, but it is state regulators that have siting authority for electric generation and transmission facilities, as well as authority over local distribution facilities (both for electricity and natural gas). These authorities can go a long way in improving the grid for both electricity and natural gas. More importantly, state regulators have the most significant authorities to encourage demand reduction measures, which can greatly mitigate the energy problems in California and the West.

The Commission will continue to take steps that, consistent with its authority, can help to ease the present energy situation without jeopardizing longer-term supply solutions. As long as we keep moving toward competitive and regional markets, I am confident that the present energy problems, while serious, can be solved. I am also confident that market-based solutions offer the most efficient way to move beyond the problems confronting California and the West.

Thank you.

Commission Staff Summary of
Recent Commission Actions on California Electricity Markets

NOVEMBER 2000

- November 1: San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CalSO and CalPX, 93 FERC ¶ 61,121 (order proposing remedies for California crisis on complaint of SDG&E)("November 1 Order")

- November 6: CPUC asks FERC to assist CPUC in investigation (Docket EL00-95-000)

- November 9: Public Conference re FERC-proposed remedies held in Washington (see 93 FERC ¶ 61,122)

- November 22: California Power Exchange Corp., 93 FERC ¶ 61,199 (order accepting amendments to streamline and clarify several provisions of the PX tariff)

- November 22: Pacific Gas & Elec. Co., 93 FERC ¶ 61,207 (order suspending PG&E transmission rate increase proposal)

DECEMBER 2000

- December 7:

  SDG&E files request for emergency relief re natural gas prices (Docket RP01-180)

  SoCal Edison files motion seeking to subpoena ISO Market Surveillance Committee data (Docket EL00-95-000)

- December 8:

  San Diego Gas & Elec. Co., 93 FERC ¶ 61,238 (order waiving operating efficiency and other regulatory requirements governing "QFs" and other small power producers to boost power output in California)

  December 8: California ISO Corp., 93 FERC ¶ 61,239 (order authorizing ISO tariff amendments to: (1) convert existing $250/MWh hard cap on bids in the real-time market into a $250/MWh breakpoint; (2) impose a penalty on generators who fail to comply with an ISO emergency order to provide power; and (3) assess costs against parties that underschedule demand or fail to deliver power.

- December 11 and 12: Motions for clarification, modification, and rehearing of December 8 ISO order

- December 13: SoCal Edison files motion for immediate modification of December 8 QF order

- December 13: California Power Exchange Corp., 93 FERC ¶ 61,260 (order accepting settlement re PX dispute resolution procedures)

- December 15: San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CalSO and CalPX, 93 FERC ¶ 61,294 (Order adopting remedial measures to reduce reliance on volatile spot markets, including: (1) eliminating requirement that investor-owned utilities sell all their generation into the PX markets; (2) requiring 95 percent of demand to be scheduled in advance and establishing a benchmark for long-term contracts; and (3) imposing an interim $150/MWh soft cap or "breakpoint" on spot markets pending development of longer term price mitigation plan)("December 15 Order")

- December 18 and 20: SoCal Edison and PG&E file emergency requests for rehearing of December 15 Order

- December 20: Marketers file emergency motion for order requiring ISO and PX not to disclose confidential information (Docket EC96-1663-000)

- December 22:

  Dynegy files complaint alleging that rates paid for energy supplied in response to an ISO emergency order are confiscatory (Docket EL01-23-000)

  Dynegy files emergency motion for clarifications of December 15 order to ensure payment to suppliers (Docket EL00-95-006)

  Commission issues data request in response to December 7 SDG & E complaint re natural gas prices

- December 26: PX files request for rehearing and stay of December 15 order (Docket EL00-95-005)

- December 29:

  Southern California Edison Co., 93 FERC ¶ 61,320 (order analyzing and accepting SoCal Edison rates for scheduling and dispatching)

Pacific Gas & Elec. Co., 93 FERC ¶ 61,322 (order rejecting PG&E filing regarding its scheduling on the ISO)

San Diego Gas & Elec. Co., 93 FERC ¶ 61,333 (order accepting SDG&E rate filing re so-called "RMR" generating units–units that must run to assure system reliability)

Southern California Edison Co., 93 FERC ¶ 61,334 (order accepting RMR tariff for SoCal Edison)

California ISO Corp., 93 FERC ¶ 61,337 (order accepting ISO grid mgmt charges)

JANUARY 2001

- January 4: ISO files tariff amendment to relax its creditworthiness standards to allow PG&E and SoCal Edison to continue conducting transactions on ISO-controlled grid, notwithstanding downgrades in their credit ratings (Docket No. ER01-889-000)

- January 5: PX files tariff amendment to relax its creditworthiness standards to allow PG&E and SoCal Edison to continue trading in the PX markets, notwithstanding downgrades in their credit ratings (Docket No. ER01-902-000)

- January 8: San Diego Gas & Elec. Co., 94 FERC ¶ 61,005 (order clarifying that December 15 Order was not intended to bar the PX from engaging in bilateral forward contracting)

- January 12:

  Pacific Gas & Elec Co., 94 FERC ¶ 61,025 (order authorizing intra-corporate reorganization of PG&E Corporation)

  Sierra Pacific Power Co., 94 FERC ¶ 61,033 (order denying rehearing re priority use of certain California grid interties)

- January 16: California Power Exchange Corp., 94 FERC ¶ 61,042 (order authorizing PX to implement emergency tariff changes to allow SoCal Edison two additional days to make its payment)

- January 18: ISO files tariff amendment to conform to December 15 order re payment procedures for RMR operations (Docket ER01-991-000)

- January 19 through February 12: Various persons, including State of California and CPUC, file requests for late intervention and rehearing of January 12 order authorizing intra-corporate reorganization of PG&E Corporation (Docket Nos. EC01-41-000 and EC01-49-000)

- January 23: PG&E files motion for immediate order to stop PX from liquidating PG&E's long-term or "block forward" contracts after PG&E refuses PX demand for payment to cover a portion of SoCal Edison's nonpayment for transactions in the PX spot markets (Docket No. EL01-29-000)

- January 23: FERC staff conducts technical conference with industry representatives re spot market monitoring and mitigation plan

- January 25: Pacific Gas & Elec. Co., 94 FERC ¶ 61,082 (order denying rehearing request re PG&E transmission rates)

- January 29: San Diego Gas & Elec. Co., 94 FERC ¶ 61,085 (order finding PX in violation of December 15 order for failing to implement $150/MWh breakpoint)

FEBRUARY 2001

- February 1: Los Angeles Dep't Water & Power files emergency petition for reimposition of price cap on natural gas pipeline capacity (Docket RP01-222-000)
- February 2:

  SoCal Edison files emergency motion for cease and desist order preventing PX from liquidating SoCal Edison's long-term "block forward" contracts to cover SoCal Edison's nonpayment for transactions in the PX spot markets (Docket EL01-33-000)

  SoCal Edison and PG&E file for immediate suspension of underscheduling penalties imposed by December 15 order (Docket EL01-34-000)

- February 6: Mirant Delta files complaint with request for fast track processing that: (1) seeks enforcement of the creditworthiness standards for PG&E and SoCal Edison in the ISO tariff; and (2) alleges ISO violation of December 15 order for failure to replace governing board (Docket EL01-35-000)

- February 7: Pacific Gas & Elec. Co., 94 FERC ¶ 61,093 (order accepting settlement re PG&E transmission rates)

- February 8 and 12, and March 2: Various parties, including Coral Power, Enron, SDG&E, Salt River Project Agricultural Improvement and Power District, Sacramento Municipal Utility District, and Public Service Company of New Mexico file three complaints requesting that the PX be barred from further implementing tariff "charge back" provision that allows the PX to recover uncollected amounts owed by PG&E and SoCal Edison from other market participants (Docket EL01-36-000, EL01-37-000, and EL01-43-000)

- February 14: California ISO Corp., 96 FERC ¶ 61,132 (order rejecting ISO and PX tariff amendments relaxing creditworthiness standards for PG&E and SoCal Edison as applied to transactions affecting third-party suppliers)

- February 15: FERC staff meets with PX regarding requirements for implementing $150/MWh breakpoint

- February 21:

  California ISO Corp., 94 FERC ¶ 61,141 (order accepting amendments to ISO tariff governing agreement among owners and addressing complaints by City of Vernon regarding conditions of becoming participating ISO owner)

  California ISO Corp., 94 FERC ¶ 61,148 (order denying rehearing of October 2000 order relating to ISO's transmission access pricing)

  Pacific Gas & Elec. Co., 94 FERC ¶ 61,154 (order denying intervention and rehearing of January 12 order authorizing PG&E Corporation intra-corporate reorganization)

- February 22: generators request order compelling ISO to comply with February 14 order re creditworthiness (ER01-889-002)

- February 23: San Diego Gas & Elec. Co., 94 FERC ¶ 61,200 (order on rehearing of December 29 order re assignment of RMR costs)

- February 26: PX files request for clarification/rehearing of February 14 creditworthiness order

- February 28:

  PX makes compliance filing proposing implementation of $150 MWh breakpoint requirement; seeks rehearing of January 29 order (EL00-95-016; EL00-98-015);

  Tucson Electric files complaint against the Governor of California challenging California's "commandeering" of PG&E and SoCal Edison's long-term contracts from the PX (EL00-95; EL01-40-000)

  Complaint filed by Strategic Energy L.L.C. versus ISO concerning out-of-market costs (EL01-41-000)

MARCH 2001

- March 1:

  ISO files revised tariff amendment on creditworthiness in compliance with February 14 order rejecting earlier proposed amendment

  California Electricity Oversight Board files motion for clarification of December 15 order

  ISO and Electricity Oversight Board file motion for issuance of refund notice to sellers, request for data, and request for hearing

- March 2: Universal Studios files complaint against SoCal Edison challenging penalties Universal was charged for failing to interrupt its service under its interruptible service contract with SoCal Edison (Docket No. EL01-42-000)

- March 7 through 23: Various persons file second round of requests for intervention and rehearing of January 12 order authorizing PG&E Corporation intra-corporate reorganization

- March 8: Ridgewood Power requests emergency relief and extension of waiver of "QF" regulations applicable to small generators (Docket No. EL00-95-018)

- March 9:

  San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, 94 FERC ¶ 61,245 (Order directing refunds or further justification for charges)

  "Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market" (Docket Nos. EL 00-95-012, *et al.*)

- March 14:

  "Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States and Requesting Comments on Further Actions to Increase Energy Supply and Decrease Energy Consumption (Docket No. EL 01-47-000) (order includes: (1) requirement that ISO and western transmission owners file list of grid enhancements that can be implemented in short term; (2) extension of waiver of QF regulations through December 31, 2001; (3) authorization for western businesses with back-up generators and customers who reduce their consumption to sell wholesale power at market-based rates; and (4) solicitation of comment on additional proposals)

Cities of Anaheim, et al. v. ISO, 94 FERC ¶ 61,268 (order dismissing in part and granting in part complaint alleging that certain cities are being charged inappropriate costs when ISO allocates the cost of power obtained through emergency orders to generators).

AES Southland, Inc., Williams Energy Trading & Marketing Co., 94 FERC ¶ 61, 248 (order directing parties to explain why they should not be found in violation of the Federal Power Act for engaging in actions that inflated electric power prices)

- March 15: Chairman testifies before the Senate Committee on Energy and Natural Resources
- March 16: San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, (notice re refunds for February transactions) (Docket Nos. EL00-95-18)
- March 20: The Commissioners testify before the House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality
- March 21: Reliant files fast-track complaint against the ISO challenging the ISO's issuance of emergency orders requiring generators to supply power (Docket No. EL01-57-000)
- March 28: CPUC v. El Paso Natural Gas Co., et al., 94 FERC ¶ 61,338 (order dismissing portion of complaint alleging affiliate abuse but ordering public hearing on whether El Paso exercised market power to drive up natural gas prices)
- March 29: ISO files motion for order directing Reliant to keep generating unit in service (Docket No. EL01-57-000)

COURT CASES

- In re: Southern California Edison Co., No. 00-1543 (D.C. Circuit Jan. 5, 2001) (petition for writ of mandamus to order FERC to set cost-based rates denied)
- San Diego Gas & Elec. Co. v. FERC, No. 00-71701 (9th Cir.)(judicial review of November 1 and December 15, 2000 orders; motion to dismiss pending)
- In re: California Power Exchange Corp., No. 01-70031 (9th Cir.)(petition for writ of mandamus to stay Dec. 15 order)

STAFF INVESTIGATIONS

The Commission's staff has completed or initiated a number of public investigations, audits, and studies of matters relating to events in California, including:

- An audit of generation outages (report issued February 2, 2001)
- An analysis of the effect of a western region-wide price cap (released in early February)
- An analysis of causes of high prices in Pacific Northwest and California (released in early February)
- Ongoing analysis of market mitigation issues (pursuant to the December 15 Order, generators are required to file weekly market /cost data--starting January 10 and every Wednesday thereafter through April 2001--for Commission review and potential refunds; Commission has 60 days from each filing to give generators notice whether refunds required)

Ms. LYNCH. Thank you, Mr. Chairman and Members.

California's restructuring experiment has erroneously been called deregulation. Rather, California Federalized the regulation of its energy prices by allowing the utilities to sell off their generating plants to private merchant generators, converting retail relationships to unbundled wholesale relationships, which created a wholesale market for electricity that was then regulated by the Federal Government, not by California.

To a much greater extent than was wise, California, under the Wilson administration, placed control of its essential economic infrastructure in the hands of the Federal Government and the Federal Energy Regulatory Commission. Federalizing control of California's grid has limited California's ability to protect our economy from price gouging and supply withholding.

To a much greater extent than was wise, California, under the Wilson administration, dismantled the integrated energy service delivery mechanisms in order to create business opportunities for speculators. The prior administration caused the utilities to sell off much of their generation to entities who now hold California hostage daily to extortionate price demands for electricity, a fundamental economic necessity that cannot be stored, and for which there is no effective substitute.

California, under the leadership of Governor Davis, is already pursuing structural reforms that will reduce our residences' and businesses' exposure to and dependence on the deregulated wholesale market. These include ending the practice of divesting utility-owned generation and selling it off to private marketeers, reacquiring control of the transmission system, and reforming the ISO and returning to a rational system of unit commitment and dispatching the grid.

The California Public Utilities Commission took a very difficult action a few weeks ago when we raised retail rates by 4 cents a kilowatt hour since January. Mr. Burton, that would equal a 60 percent increase in your district in Indiana. It may not be enough if the current price-gouging practices persist and remain unabated by Federal regulators.

I have prepared an exhibit that is attached to my testimony that illustrates what has happened in the California wholesale pricing market. From April 1998, when the California market opened, to January 2000, wholesale prices remained at traditional levels, $30 to $35 per megawatt hour. But beginning in January 2000, wholesale prices began to climb, averaging about 60 percent above the previous year. Beginning in May 2000, average prices climbed to over $100 a megawatt hour, reaching a peak of $166 per megawatt hour in August, 200 to 300 percent above historic levels.

On November 1st, the Federal regulators indicated an intention to abolish price caps in the California wholesale market and prices began a further upward spiral. On December 8th, the FERC, in a secret order procured by Mr. Winter, without notice to a single California State policymaker or elected official, eliminated all price caps, and average prices rose to $377 per megawatt hour for the month of December, a level 10 times the historic average. Wholesale prices for electricity in California have remained at about that level since, and they bear absolutely no correlation to demand, since these prices are occurring right now at the lowest load levels of the year. It is significant that peak demand has not increased significantly in the past 4 years. The same plants are running that have served load in California for the past 30 years, using the same fuels, and with the same pollution emissions profiles.

But the practice of physical and economic withholding continually puts California on the ragged edge. Any shortage of generation to meet demand has been due to the failure of the merchant generators to provide sufficient supply, and the failure of past administrations to require that electricity supply be built. Prior to restructuring, California added over 15,000 megawatts of new generation from 1980 to the mid-1990's. In addition, thousands of megawatts were obtained from aggressive conservation programs and new interstate transmission lines.

During the 1980's, California added power plants, notwithstanding our appropriate environmental requirements that were then in place. However, all this development stopped in the mid-1990's when California, under the Wilson administration, unwisely decided to depend on the competitive, unregulated market.

Under Governor Davis, California is now taking every action to expedite the development of new generation. We are restarting long-retired utility power plants; we are providing incentives for distributed generation and renewable energy projects; we are streamlining the permitting of large power plants that are much more efficient and cleaner-running than current plants. We are obtaining waivers from Federal regulators to allow qualifying facilities to increase generation capacity, and California is making a historic commitment of ratepayer and taxpayer moneys to provide $1.5 billion in energy efficiency incentives to our businesses and families so that we can use electricity as wisely and as effectively as possible. California's energy efficiency commitments dwarfs comparable Federal commitments.

However, all these changes under Governor Davis may not be sufficient to stem our problems we are facing this summer, particularly in light of suppliers' ability to withhold generation capacity. You know, we are experiencing the application of a strategy that was clearly articulated years ago by the merchant generators. And I would like to quote. "We have a lot of experience dealing with summer peaks in dispatching plants." This is a quote from Mr. Oglesbee, who is President of Reliance Marketing Subsidiary. He says, "When you operate on a merchant basis and sell into a power exchange, you can watch the price climb during the day. We might decide to hold our plant off the market at 12 noon, even if the price looks favorable, because we can get a better price at 4 p.m. We think we know a little bit about what will happen if we hold our plant out a few hours. We can play on that expertise." And my testimony has the quote from Mr. Oglesbee.

What we realize is that the merchant generators will hold California over a barrel unless the Federal regulators do their job. The Federal Power Act provides for cost-based rates. The act requires just and reasonable wholesale rates, or else, under the statutes that Congress passed, those rates are unlawful. Where market power exists, all sellers must have cost-based rates. One part of the answer to California's dilemma is to move back to cost-based rates as quickly as possible, given the market that even the FERC calls dysfunctional. The Federal law requires it. If FERC is unwilling to enforce the laws on its own that are currently on the books, the Congress should direct the FERC to do so.

I have additional testimony. I see my time is running short, so I would like to wrap it up. But I would like to be open to questions, especially about long-term contracts, because the committee had asked specifically for testimony about that. But I would like to address one final issue, which is the cost of natural gas in California. Wholesale natural gas is twice as expensive in California as anywhere else. This is entirely a function of the cost and lack of availability of interstate transportation.

Again, the practice of withholding and price gouging, the classic symptoms of unlawful market power of the kind the Natural Gas Act was intended to prevent, is victimizing California without a remedy from the FERC. The remedy here is for Congress to require the FERC to reverse its ill-considered 2-year regulatory exemption of the natural gas secondary market, and to re-regulate the secondary market for natural gas transport so that the infrastructure that consumers have built and paid for is fully utilized.

Many fingers have been pointed over California's energy crisis, but the cause is simple and fundamental. The Federal market cops decided to leave the beat, leaving the market completely unattended. The Nation has seen this situation play out before in the 1920's, when electricity and natural gas providers kept the whole Nation over a barrel. That gaming and gouging led to the 1935 Federal Power Act that Congress passed, a statute that was designed to protect businesses and consumers from sellers who possessed market power. We face that situation again today, and Congress should require FERC to enforce the Federal statutes already on the books.

Mr. OSE. Ms. Lynch, we are going to wrap up your——

Ms. LYNCH. Sure. I have submitted testimony with several documents——

Mr. OSE. You have testimony?

Ms. LYNCH [continuing]. Responding to the questions the committee had asked me to prepare.

Mr. OSE. We will submit your written statement for the record. We appreciate your giving it to us.

Our next witness is Mr. Terry Winter, who is the president and CEO of the California Independent System Operator. Mr. Winter, I have been kind to Mr. Madden and Ms. Lynch, but I am going to give you 5 minutes.

Mr. WINTER. That is not unusual for me.

Mr. OSE. All right.

[The prepared statement of Ms. Lynch follows:]

TESTIMONY OF LORETTA LYNCH,
PRESIDENT OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION
before the
COMMITTEE ON GOVERNMENT REFORM
of the
U.S. HOUSE OF REPRESENTATIVES
April 10, 2001

MR. CHAIRMAN, MEMBERS:

Thank you for inviting me to testify about the causes of the dire economic crisis facing California, brought on by a profoundly mistaken experiment in "deregulation" of California's energy supply system.

California's restructuring experiment has erroneously been called deregulation. Rather, California federalized the regulation of its energy prices by allowing the utilities to sell off their generating plants to private merchant generators, converting retail relationships to unbundled wholesale relationships, creating a wholesale market for electricity that was regulated by the federal government, not by California.

To a much greater extent than was wise, California placed control of its essential economic infrastructure in the hands of the federal government, and the Federal Energy Regulatory Commission (FERC). Federalizing control of California's grid has limited our ability to protect California's economy from price gouging and supply withholding.

To a much greater extent than was wise, California dismantled – the term in the industry is "unbundled" -- the integrated energy service delivery mechanism, in order to create business opportunities for speculators. The prior Administration under Governor Wilson caused the utilities to sell off much of their generation to entities who now hold us hostage daily to extortionate price demands for electricity, a fundamental economic necessity that cannot be stored and for which there is no effective substitute.

We expect that the federal government will eventually enforce the law. As Mr. Winter has suggested, the overcharges since last May run into the many billions of dollars, and we expect to recover that eventually, once California has the opportunity to move through the FERC administrative processes and go to court.

California under the leadership of Governor Davis is already pursuing structural reforms that will reduce our residents' and businesses' exposure to and dependence on the deregulated wholesale market. These include:

- ending the practice of divesting utility owned generation;
- reacquiring control of the transmission system;

- reforming the ISO and returning to a rational system of unit commitment and dispatching the grid;

FERC's failure to enforce the law – to require that wholesale electric rates be just and reasonable – has created an untenable situation. California faces an unbounded wholesale price risk and a dysfunctional market, characterized by pervasive market power of the sellers to demand and receive unconscionable prices and profits. Under these circumstances, no one – not the utilities, not the banks, not the state, not the ratepayers – will accept and fund an unlimited risk. California is literally being plundered, with the full knowledge and consent of the FERC.

California has raised retail rates by 4 cents a kilowatt hour since January. That would equal a 60 percent increase in your district in Indiana, Mr. Chairman. It may not be enough, if the current price gouging practices persist and remain unabated by federal regulators.

I have prepared an exhibit that illustrates what has happened:

- From April 1998, when the California market opened, to January 2000, wholesale prices remained at traditional levels – $30 to $35 per megawatt hour. Beginning in January wholesale prices began to climb, averaging about 60 % above the previous year.

- Beginning in May 2000, average prices climbed to over $100, reaching a peak of $166 per megawatt hour in August, 200 to 300 percent above historic levels.

- On November 1 the FERC indicated an intention to abolish price caps, and prices began a further upward spiral.

- On December 8 the FERC – in a secret order procured by Mr. Winter without notice to a single California state policymaker or elected official – eliminated all price caps, and average prices rose to $377 dollars per megawatt hour for the month of December, a level ten times the historic average. Wholesale prices for electricity have remained at about that level since. The wholesale prices in California's electricity market bear absolutely no correlation to demand, since these prices are occurring during the lowest load periods of the year.

It is significant that peak demand has not increased significantly in the past four years; the same plants are running that have served load in California for the past thirty years, using the same fuels and with the same emissions profiles. But the practice of physical and economic withholding continually puts us on the ragged edge.

Any shortage of generation to meet demand has been due to the failure of the merchant generators (unregulated by California) to provide sufficient supply and the failure of past Administrations to require that supply be built. Prior to restructuring, California added over 15,000 MW of new generation from 1980 to the mid 1990s. In addition, thousands of megawatts were obtained from aggressive conservation programs and new interstate transmission lines. During the 1980s, California added new power plants notwithstanding appropriate environmental requirements then in place.

However, all this development stopped in the mid 1990s when California under the Wilson Administration unwisely decided to depend on the competitive unregulated market to provide new generation supply. Under Governor Davis, California is now taking every action to expedite the development of new generation. California is:

- restarting long-retired utility power plants;
- providing incentives for distributed generation and renewable energy projects;
- streamlining permitting of large power plants that are much more efficient and cleaner-running than current plant stock;
- obtaining waivers from federal regulators to allow qualifying facilities to increase generation capacity; and
- making a historic commitment of ratepayer and taxpayer funds to provide $1.5 billion in energy efficiency incentives to businesses and families to use electricity as wisely and effectively as possible. This dwarfs comparable federal commitments.

However, all these changes under Governor Davis may not be sufficient to stem problems this summer, particularly in light of the suppliers' ability to withhold generation capacity needed in the California market.

California is experiencing the application of a strategy that was clearly articulated several years ago by Reliant Industries:

> "We have a lot of experience dealing with summer peaks and dispatching plants. When you operate on a merchant basis, and sell into a power exchange, you can watch the price climb during the day. We might decide to hold our plant off the market at 12 noon, even if the price looks favorable, because we can get a better price at 4 p.m. We think we know a little bit about what will happen if we hold our plant out a few hours. We can play on that expertise."

Public Utilities Fortnightly, November 15, 1997, page 5, quoting Houston Industries [Reliant's predecessor] Executive Charles Oglesby. Mr. Oglesby is now President of Reliant's marketing subsidiary.

The Federal Power Act provides for cost based rates. The Act requires just and reasonable rates, or else the rates are unlawful. Where market power exists, all sellers must have cost based rates. One part of the answer to California's dilemma is to move back to cost based rates as quickly as possible. The federal law requires it. If FERC is unwilling to enforce the law on its own, the Congress should direct it to do so.

All other state grids have rational unit commitment rules that assure that the plants needed to run for local reliability do in fact run. As Mr. Winter has described, California does not have that same approach. When the new ISO board proposes unit commitment rules and dispatch protocols, the FERC should approve them expeditiously with due regard for ratepayer protections.

It is claimed that long term, multiyear contracts are another method for reducing exposure to wholesale price gouging. I have prepared an exhibit showing the history of CPUC actions relative to long-term contracts. Utilities have had ample opportunity to sign such contracts and for the most part have not.

I want to emphasize that this represents their business decision. There are several reasons why they may have decided not to sign.

First, it is apparent that the prices are too high based on all previous experience. This was as true in September 2000 as it is in March 2001, when some members of the minority party in the California legislature are criticizing the California Department of Water Resources for entering into long term contracts. Market power distorts all pricing in this market. Market power in short-term markets extends into market power in longer-term markets.

Everyone, from the utilities to the governor, believed that FERC would act sensibly and restore order to the short-term markets which would in turn bring order to the longer term markets. A rational decision could be made at that point. FERC failed.

Second, the utilities were not, and are still not, prepared to take on long-term procurement responsibilities in the absence of responsible FERC action. I don't blame them.

There is one other issue that I want to address: the cost of natural gas in California. Wholesale natural gas is twice as expensive in California as anywhere else in the country. This is entirely a function of the cost and lack of availability of interstate transportation. Again, the practice of withholding and price gouging, the classic symptoms of unlawful market power of the kind the Natural Gas Act was intended to prevent, is victimizing California without a remedy from the FERC.

California has depended on a competitive market – gas to gas competition based on costs of different supply basins – to maintain reasonable energy costs. The supply basin relationships have been disrupted by withholding and manipulation of margins on the El Paso system. The FERC, presented with smoking gun evidence by the PUC a year ago, has refused to act. Instead, two weeks ago, facing increasing pressure to stop sitting on California's evidence, the FERC stretched out their hearings on California's complaint to a point in time – the end of May – when the anti-competitive natural gas contracts complained of will expire. This leaves California with no effective remedy, since the FERC at the same time refused to consider retrospective relief.

The remedy here is for Congress to require FERC to reverse its ill-considered two-year regulatory exemption of the natural gas secondary market and to re-regulate the secondary market for natural gas transport, so that the infrastructure we have built and paid for is fully utilized.

Many fingers have been pointed over California's energy crisis. But the cause is simple and fundamental – the federal market cops decided to leave the beat, leaving the market completely unattended. The nation has seen this situation play out before – in the 1920s when electricity and natural gas providers kept the whole nation over a barrel. That gaming and gouging led to the 1935 Federal Power Act, a statute that was designed to protect businesses and consumers from sellers who possessed a fundamental economic necessity – electricity.

Congress should require FERC to enforce the federal statutes already on the books. If Congress fails to require FERC to do its job, California now but the nation soon will face the same economic turmoil as in the 1920s.

I have several documents to attach to my testimony that I would also like to submit for the record.

Thank you.

Average Uncongested PX
Market Clearing Price
$/MWh

	1998	1999	2000
January		20.96	31.18
February		19.03	30.04
March		18.83	28.80
April	22.60	24.01	26.56
May	11.65	23.61	47.22
June	12.09	23.52	120.20
July	32.42	28.92	105.72
August	39.53	32.31	166.24
September	34.01	33.91	114.87
October	26.65	47.64	101.52
November	25.74	36.91	170.06
December	29.13	29.66	376.99

Source: California Power Exchange

CALIFORNIA PUBLIC UTILITIES COMMISSION
ENERGY ACTION TIMELINE
APRIL 10, 2001

June 14, 2000	PG&E experiences supply-related rolling blackouts
July 21, 2000	PG&E & SCE apply for bilateral contracting authority outside PX
June 28, 2000	ISO votes to reduce wholesale electricity price cap in CA from \$750/MW to \$500/MW; generators sue at FERC.
August 1, 2000	ISO votes to reduce wholesale electricity price cap in CA from \$500/MW to \$250/MW.
August 2, 2000	At the request of Governor Davis, Michael Kahn & Loretta Lynch issue report detailing electricity pricing problems in the wholesale market and recommend FERC action and structural changes.
August 3, 2000	PUC allows utilities to enter into bi-lateral long-term contracts outside the PX up to average net short, 14 days after application. PUC initiates investigation of sellers' market behavior.
August 21, 2000	PUC passes limited rate stabilization for San Diego customers exposed to wholesale market pricing.
August 23, 2000	FERC opens investigation into San Diego wholesale pricing.
September 6, 2000	Legislature passes & Governor Davis signs AB 265, setting 6.5 cent rate for San Diego residential & small commercial customers.
September, 2000	PUC, EOB and FERC investigate California wholesale electricity market malfunctions.
September 29, 2000	Governor Davis calls for FERC to investigate and require reasonable price caps in CA's wholesale electricity market; PUC files in support of reasonable price caps.
October 4 & 6, 2000	PG&E and SCE file at the PUC to end the rate freeze and institute market pricing throughout CA.
November 1, 2000	FERC issues draft order removing CA's authority to set effective price caps; FERC finds CA prices unjust and unreasonable.
November 22, 2000	PUC & EOB file evidence at FERC showing market manipulation and requesting rate caps or cost-based rates.
December 8, 2000	FERC removes any price cap protection for CA wholesale electricity markets without due process or notice.
December 15, 2000	FERC issues final order declaring CA prices unjust and unreasonable but fails to impose workable price caps in the CA wholesale market.

December 21, 2000	PUC initiates action to analyze utilities' rate increase claims; authorizes independent auditors to evaluate utilities' financials.
January 3, 2001	Governor Davis calls special legislative session on energy.
January 4, 2001	PUC temporarily raises rates one cent, sets 90 day schedule for independent audit and evidentiary hearings on price increases.
January 18, 2001	AB 6x passes, requiring utilities to retain remaining generation.
January 17, 2001	California Department of Water Resources begins purchasing electricity on behalf of Edison's and PG&E's customers.
January 29-30, 2001	Independent auditor reports confirm cash flow difficulties for Edison and PG&E.
January 31, 2001	PUC moves to implement AB 6x and SB 7x, requiring utilities to convert to cost based rates for utility-owned generation • PUC authorizes over $314 million in energy efficiency funds to be used to reduce demand this summer. • PUC allows enhanced security for PG&E natural gas sellers to keep natural gas flowing to customers
February 1, 2001	AB 1x passes, authorizing CDWR to enter into long term contracts and issue bonds for power purchase repayments. Requires CPUC to ensure payment to the State for power purchases.
March 15, 2001	Independent auditors update utility audits, finding Edison and PG&E maintain over $2 billion in cash on hand; PUC prohibits utilities from laying off workers needed to maintain service
March 27, 2001	Directed PG&E and SCE to pay QFs for power delivered, to ensure continued generation from these facilities; • Required the utilities to pay the State for its portion of power purchased on behalf of PG&E and Edison's customers; • Authorized an additional three cent emergency rate increase for customers of PG&E and SCE to stabilize the availability of wholesale electricity to CA businesses and families. • Approved additional funding of over $100 million annually to facilitate the development of distributed generation projects
April 3, 2001	Initiated an investigation of utility holding companies' actions and standards to assure compliance with Commission orders to protect the financial status of the utilities • Directed PG&E to initiate biological studies of the "Path 15" transmission corridor to expedite upgrades to the facilities • Reformed "interruptibles" rate programs to increase program options in response to business customer needs and to allow for greater reductions in demand for the summer of 2001 • Authorized a mechanism to provide that funds from utility rates are available for purchases of power by the Department of Water Resources.

THE TRUTH ABOUT FORWARD CONTRACTING AUTHORITY IN CALIFORNIA

As wholesale electricity prices began skyrocketing in mid-2000, some have argued that utilities should enter into long term bilateral contracts as a way of stabilizing prices to the ultimate consumers of electricity. Others claim that California consumers and utilities would have been protected from high power prices if the CPUC permitted bilateral contracting authority earlier.

Wilson Administration PUC Commissioners in fact restricted the utilities' ability to enter into long–term forward and bilateral contracts. Those Commissioners, who served when the PUC promoted the restructuring law passed in 1996, believed that the utilities should buy and sell power through the PX to assure a "transparent" market price for power and promote competitive markets in California. It was one of many mistakes for which California is currently paying.

As Governor Davis' appointees joined the Commission, the CPUC has reconsidered its forward contracting policy. Since January 2000 all five Commissioners have voted ten times to approve utility requests for authority to enter into bilateral contracts. In several cases, the Commission authorized this authority over the vehement objections of power sellers. On August 3, 2001, the Commission authorized bilateral contracting for the full average net short within two weeks of the utilities' application.

In December 2000, the President of the CPUC initiated reconsideration of the Commission's contracting guidelines issued the previous August, a clarification that PG&E sought in a letter dated October 16, 2000. The CPUC President proposed an order for the Commission's consideration that would have created clear guidelines for the utilities in their contracting efforts.

All three utilities have taken advantage of the authority the CPUC granted to them by entering into PX forward contracts and bilateral contracts. In a letter sent to the Commission on October 31, 2000, SCE expressed its understanding that the contracts it had signed were per se reasonable under the Commission's August 3rd guidelines.

Purchasing power through bilateral contracts presents both risks and advantages to California customers. While bilateral contracts may stabilize prices, they may also lock in high wholesale prices for many years. Moreover, the CPUC cannot hand the utilities a blank check to purchase power without any regulatory oversight, as some have suggested, because doing so would provide no incentive for the utilities to purchase power wisely. No other state cedes its regulatory responsibility to ensure reasonable procurement costs.

California's energy crisis is the result of the convergence of many complex circumstances. The CPUC will continue to work hard to find solutions to the current crisis and to balance the interests of California's businesses and families as we work through these extraordinary pricing challenges.

Mr. WINTER. Thank you, Mr. Chairman and Members of the Congress.

First off, I would like to explain what the ISO does. We are the operator of the transmission system, and we take schedules. We are not always privy to what all the prices are. Many bilateral contracts go through us that we never see, so oftentimes people are asking us to identify what all the costs are. We have no way of doing that. Our job is to perform the scheduling on the system, and to ensure that it operates reliably. And last but not least, we are the ones that, in the end, if there is not sufficient supply and we must interrupt firm load, we are the ones that make that order.

There are four things that I would like to very briefly talk about and try to stay within my 5 minutes. The first, a comment on the bankruptcies that we have now faced; second is today's operation, what we go through; third is the summer load that we are looking forward to and fourth, market costs.

My statement on bankruptcy is that one of the things that the operator needs desperately is some stability to what is going to happen during the day. And because of that, I think it is incumbent upon us to make sure that these companies that have moved into bankruptcy continue their attention on the operation, and I believe PG&E's first motion was to ensure that their employees would be paid, etc. I think that is a good start. But we also have many plans for transmission lines that they are building at the current time, and we need to ensure that they have the financial wherewithal to continue that building, because that will be part of our solution to serve the customers and the ratepayers of California.

Today's operation, I do not think I can begin to explain to you all, without an hour or two, or actually have you out there, what it means to come in at 7 a.m. and sit down with the operators who are facing a 5,000 to 7,000 megawatt shortage that day as they move into their 7 a.m. timeframe. That means at that point we have to go out into the market and beyond the market to get all available generation. We face that every day. And this summer we had periods when we were actually 16,000 megawatts short.

Looking forward to this summer, forecasting is always a dangerous business, but I will tell you that we have done a rather pessimistic report, which we are paid to do, quite honestly, because we have to consider some of the worst cases. But that shows in June that we will be about 3,700 megawatts short on peak. Now, that decays as we move on into the summer because of new generation. There is approximately 2,500 megawatts of generation that will be coming online in July and August of this year, so it moves down to around the 600 megawatt timeframe or level.

But it should be noticed that, while we have not factored in things like conservation and the impact that increased prices will have, we also, on the other side, have not looked at the worst possible heat, summer, we have not looked at the worst possible situation of import from out of State. To give you an idea, in 1999 we were importing 9,000 megawatts from other States. Last year we were importing between 5,000 and 6,000. Right now, I am extremely lucky if I can get 1,000 to 1,500 from out of State. And what that has resulted in is that we have to run in-state generation about 20 to 30 percent more than we ever have in the past.

Moving on to markets, we were constantly asked how much we felt the market was being paid above what would be a normal competitive hourly rate in normal markets. Our figures show that there is a little over $6 billion cost that we cannot explain either through scarcity, cost of natural gas, cost of higher emissions, etc. We have filed those reports with FERC, and hopefully they will be able to review those and make their findings on those, because we do not always have all the information. But just in broad figures, that is about a 35 percent increase over what we would expect in competitive markets, which allow for a portion of it to be paid above cost base just because of the lack of supply.

With that, I will stop and hold to my 5 minutes.

Mr. OSE. Thank you, Mr. Winter. The trap door will not open underneath you. [Laughter.]

Our final witness is Mr. Larry Makovich, who is the senior director at Cambridge Energy Research Associates. Mr. Makovich for 5 minutes.

[The prepared statement of Mr. Winter follows:]

Statement of Terry Winter
President and Chief Executive Officer
California Independent System Operator Corporation
Before the
House Committee on Government Reform
Sacramento, California Field Hearing
April 10, 2001

Mr. Chairman and members of the Committee, thank you for inviting me to share with you my perspectives on the electricity supply problems now confronting California. I do so from a unique vantage point and experience base. Since the spring of 1998, the California ISO has had operational responsibility for most of California's electric transmission grid -- the network that is critical to reliability and to competitive commerce.

From that experience I readily confirm the reality that brings this Committee here today: unquestionably the market is not workably competitive and the consequences have been serious. I plan, presently, to describe for you the realities that regularly confront the ISO and some of the challenges that will have to be met in California and throughout the west over the coming months. But given this Committee's jurisdiction over matters of economic growth, competitiveness and regulatory issues, I would be remiss if I failed first to begin by discussing with you the implications of two very recent significant occurrences: the announcement by Pacific Gas & Electric Company of its decision to file for bankruptcy and the decision issued by the FERC this past Friday.

As to the former, we literally are in uncharted waters. While this is not the first utility bankruptcy, it is the first of this scale and it represents the first time, to my knowledge, that the debtor in possession will not have available to it sufficient generation capacity with which to serve its customers reliably.

I certainly am in no position to comment on the full implications of the bankruptcy filing but it would be a mistake to assume business as usual. I am comforted by PG&E's announcement of its continuing commitment to the discharge of its utility responsibilities. From the standpoint of the ISO, it is absolutely critical that the transmission system and the generation capacity that remains under PG&E ownership and control be maintained consistent with good utility practice. We trust that the bankruptcy court will assure the company's ability to meet those commitments.

Nevertheless, concerns remain. It is no secret that for most of the decade preceding restructuring in California, utility infrastructure investment was sorely deficient. Since its formation, the ISO has expended considerable resources on the identification of essential transmission reinforcements. These necessary investments span the gamut from the relatively modest upgrade of existing facilities to, at the other extreme, the need for brand new lines. The transmission bottlenecks that currently restrict commerce between southern and northern California and other areas within California must be reduced or eliminated as early as is practicable if reliability of service and efficiency of supply is to be assured. The ISO has identified no less than 170 such projects as necessary to maintain reliability on the PG&E network over the next five years.

Moreover, the ISO and the state are aggressively pursuing expansion of Path 15, a critical transmission corridor between Southern and Northern California. Transmission constraints on Path 15 have prohibited the ISO from utilizing the generating resources dispersed throughout California in the most economical fashion. Indeed, Path 15 constraints, and the ISO's resultant inability to deliver critical supplies of power to Northern California, were the primary cause of the most recent rolling blackouts in California. In the future, the ISO must ensure that the regional transmission system and California's interconnections with its neighbors are expanded in a manner that assures California will have access to new power supplies in the region. The California supply problem will not be solved, indeed, regional reliability and efficiency will be impaired, if those projects are delayed unnecessarily. But they will require incremental investment and that, frankly, is why I have a concern. Will the bankruptcy court, with its traditional focus on maximizing the value of the debtor's estate, recognize the criticality of allowing these investments to go forward?

From the ISO's standpoint, it has been challenging enough without this added complication. The bankruptcy certainly will add complexity to the successful maintenance of grid reliability, particularly if the reorganization of PG&E takes an extended period of time. We are, as I said at the outset, in uncharted waters.

As to the recent FERC action, I must tell you that it came as a complete shock and, quite frankly, if it stands without modification, it will certainly complicate our ability to maintain the reliability of the interconnected grid. I certainly have no intention of using this forum to resolve issues that properly are the subject of FERC litigation. However, your understanding of the reliability challenges that face California and the western United States would be seriously deficient if I failed to mention the implications of the actions taken by the FERC this past Friday. To put the issue in perspective, it is necessary that I first briefly describe for you the principal functions of the ISO as it strives to keep supply and demand in equilibrium, without which grid frequency cannot be maintained and the shedding of load becomes inevitable.

When the California market was developed, it was expected that the overwhelming majority of supply would be arranged for in advance of actual need, with adjustments made in an hour-ahead market. However, it is never possible, in advance, to predict with precision the supply that actually will be needed to meet the demand that appears in real time. And, even if the required level of supply were anticipated and committed in advance, unanticipated outages do occur. Therefore, it is and always will be necessary for the system operator to take actions to fine tune the alignment of supply and demand in real time.

The ISO prefers to be able to accomplish that fine tuning by calling upon bids that have been provided to it in advance. That bid tells the ISO the additional energy that the bidder would be willing to provide and at what price. But increasingly of late we run out of energy that has been offered pursuant to such bids and when that occurs we are left with but two options by which to bring supply and demand into equilibrium: we can curtail service to customers, or we can call upon available generation that is not covered by a bid to respond and to meet the need. We do the latter by issuing emergency dispatch instructions. Because the shedding of load is, under applicable reliability criteria, to be taken as a last step only after all other options for the maintenance of reliability have been exhausted, it has been the ISO's practice to issue dispatch instructions when that was the most reasonable available alternative.

I want to assure you that we issue dispatch instructions only when, in our judgment, it is absolutely necessary to do so if a system emergency is to be averted. On February 14th the FERC issued an Order clarifying that the ISO could accept a schedule only if the generation that was included in the schedule was either utility-owned or supported by a credit-worthy purchaser. The February 14th Order, however, left intact the ability of the ISO to issue dispatch instructions to avert a system emergency in real time without regard to credit considerations – a construction of that Order that was not simply that of the ISO, but of a federal district court. On Friday evening FERC changed its Order and said that the ISO may no longer issue dispatch instructions without the backing of a credit-worthy entity.

Again, the FERC Order certainly will complicate the ability of the ISO to maintain the reliability of the interstate grid – a responsibility that the FERC itself entrusted to the ISO. I can tell you what I have instructed my operators to do. If there is capacity available that can help us avert or lessen a system emergency, they are to continue to issue dispatch instructions. It would be my hope that the generators who can help will do so; that they will recognize their public responsibility, particularly as they operate under FERC-approved rate schedules that allow them to charge market-based rates for the overwhelming majority of their capacity. If they choose not to respond it will be their choice and they will bear the consequences. For the ISO's part, however, we will continue to do everything in our power to make clear what must be done to maintain reliability and the provision of this essential service.

A Day in the Life of the ISO

Even before the events that I have just discussed, from the ISO's perspective the current situation remains challenging, and we expect these operational difficulties to increase as summer approaches. On a typical day, we face a 5-7000 MW shortfall between scheduled generation and expected load. Over the summer we have experienced shortfalls as high as 16,000 MW between the scheduled generation and load.

It often is the case that between 10,000 and 17,000 MW of generation is off-line due to planned and forced outages. There are numerous reasons why these units are off, several of which still are under investigation. Among the facts already know, 64% of the California units are more than 35 years old and just require more maintenance. Another is that these units on average ran 20% more than previous years, while having less time for maintenance. Additionally, air quality retrofits requiring extended outages are being installed. Couple these problems with low hydro production, concerns over payment and high gas prices, and you have a market that does not meet demand.

Before leaving this topic I need to stress the truly extraordinary efforts made by the State of California and the people of California to conserve energy during power emergencies, and the success of our demand relief programs. We have three levels of power emergency at the ISO. At Stage One, when reserves drop below the regional standards established by the Western Systems Coordination Council, consumers are asked to voluntarily reduce consumption, and our experience is that they respond to our appeals in significant numbers. At Stage Two, when reserves drop below 5%, we implement our interruptible load programs. At Stage Three, when reserves drop below 1.5 percent, we are forced to consider involuntary load reduction - blackouts - to maintain the stability of the grid.

Last year we had 500-600 MW bid into the ISO Participating Load Ancillary Services Program by large water projects that can turn off their pumps to reduce load. The ISO's Demand Relief Program also allows us to interrupt load during periods of tight supply. The new ISO Discretionary Load Curtailment Program will provide a way for smaller loads, and loads that require total control over their curtailments, to be compensated for voluntarily agreeing to be curtailed during tight supply. Be assured that the programs that have been implemented by the ISO are being coordinated with the broader, complimentary conservation and demand-side management programs of the state. But the most important, and largest, program to reduce consumption remains the individual efforts of millions of Californians and California businesses to reduce their electricity consumption.

Forecast for Summer 2001

You have asked us to comment on our current projections of the electric service to end-use customers in California this summer. The Operations and Engineering Department of the California ISO has recently prepared a report entitled "CAISO 2001 Summer Assessment" that I would like to submit for the record. In this report, we detail the expected loads in the ISO control area, our expectations for generation capacity in the control area, expected imports and the load reductions we expect from mitigation measures.

While the report is based on a number of assumptions, which I will detail in a moment, it concludes that we expect "an electricity shortage of unprecedented proportions" and that the "forecast deficiency suggests that California will experience rotating blackouts for periods this summer." Specifically, the report forecasts that we will be nearly 3,700 MW short in June, with the shortfall decreasing to about 600 MW by September as new generation is expected to come on line.

When viewing these numbers, there are several important points to consider that suggest the reality this summer may be less bleak. First, the report tries to be conservative. We have not included conservation opportunities, or the impacts of retail rate increases on consumption. We have used a conservative number on demand response programs as well as peaking units which may be available for the peak requirements. These programs are all being actively pursued by the ISO and the state. Another area actively being pursued by the state is the modification of air quality permit requirements to allow existing generators to maximize their output. And, of course, the whole financial viability of the electric market is being addressed. Finally, the projected shortfall assumes that at all times we will continue to meet the current standard for operating reserves.

However, you should also be aware that there are a number of scenarios that could mean the actual situation this summer will be worse than forecast. First, the forecast assumes that all of the electricity generated in the ISO control area will be sold to meet the needs of consumers in the ISO control area. This almost certainly will not be the case as some portion of this summer's generation capacity has already been contracted to out-of-state buyers. Our lack of knowledge of the amount of these export sales adds a great deal of uncertainty to any projection about how much power will be available to serve California load this summer.

The weather will also play a crucial factor. While the snow pack figures may change, our report indicates that California snow pack is averaging 25% below normal, with snow pack in the Northwest ranging from 22-78% below normal. This could greatly affect imports into the California market. And, as always, what the temperature does this summer will have a great impact on actual load. We are also concerned about the amount of qualifying facility generation that will be in the market this summer in light, in particular, of the current financial crisis. Finally, PG&E's bankruptcy filing adds an additional element of uncertainty.

ISO Report on California Electricity Markets

You have also asked us to discus our views on the exercise of market power in the California markets, and the amount that electricity costs exceeded the costs expected under robust competitive conditions. On March 22nd, the ISO's Department of Market Analysis (DMA) submitted two studies of market power as part of our comments on FERC Staff's "Recommendations on Prospective Market Monitoring and Mitigation for the California Wholesale Market." The first of these reports[1] was a top-down analysis of the impact of market power on overall system prices based on the system price-to-cost markup for the combined Power Exchange (PX) and ISO markets and other bilateral transactions scheduled through the ISO. When extrapolated to the total wholesale energy market (excluding generation owned or under contract to the major

[1] *Further Analyses of the Exercise and Cost Impacts of Market Power In California's Wholesale Energy Market,* prepared by Eric Hildebrandt, Manager of Market Monitoring, March 2001 (the "Hildebrandt I" report).

utilities), results of this study showed potential additional net costs to consumers of over $6 billion between May 2000 and February 2001. This figure does not include additional costs of $600 million to consumers during hours of extreme supply scarcity, when prices might be expected to rise even without the exercise of market power.

The report also examined actual wholesale prices and the estimated competitive market baseline prices in relation to the cost of investment in new supply. The conclusion reached is that on an annualized basis, wholesale energy prices since January 2000 have exceeded the cost necessary for new investment by about 400%, and would allow recovery of an investment in new supply in a period of less than two years. Thus, this analysis indicates that any market power mitigation plan that is adopted on a going forward basis may be designed to reduce significantly wholesale prices observed over the last year, while still providing sufficient opportunity for recovery of costs in new investment.

The second study[2] examined the bidding behavior of 21 individual market participants, and identified individual suppliers responsible for setting high market clearing prices through their individual bids. The fundamental finding of this study is that a wide range of suppliers systematically bid capacity into the ISO real time market at prices several times higher than the actual cost of production. The study thus provides a direct link between the observed pattern of prices and the bidding behavior of individual suppliers.

For the record, I would like to clarify that neither these reports nor the ISO's March 22nd filing deals explicitly with the issue of requested refunds. The purpose of these studies was to provide further evidence of the exercise of market power in California's wholesale energy markets over the last year and to emphasize the need to take effective, comprehensive action to prevent continuing widespread abuse in the future. In our recent request for rehearing of FERC's March 9th Order concerning potential refunds for sales during January, we have stated that these reports should

[2] *Empirical Evidence of Strategic Bidding in California ISO Real-time Market*, prepared by Anjali Sheffrin, Director, Dept. of Market Analysis.

provide further impetus for the Commission to initiate hearings to develop an appropriate record to determine the level of refunds that should be directed in view of the exercise of market power.

Recent Developments

Since we filed these reports, the Commission has asked us to distinguish the amounts attributable to entities under FERC jurisdiction from the amounts attributable to non-jurisdictional entities. The Commission also asked us to distinguish the amounts incurred before the October 2, 2000 date established in the Commission's December 15th order.

In filings Friday and yesterday, we provided the data sought by the Commission. In response to your request, I would like to share some of that data with you today. While the previous analysis[3] used a "top down" system-level approach, the new report[4] uses a "bottom-up" accounting and analysis of hourly market energy schedules and sales by each individual market participant[5]. This analysis estimates potential costs in excess of competitive levels for the total wholesale market in excess of $6.7 billion during the period May 2000 through February 2001 (including $430 million in the Ancillary Service markets not included in the earlier analysis).

Approximately $4 billion of the $6.7 billion of potential excess costs identified in this study can be tied directly to specific schedules and transactions in the PX and ISO

[3] The Hildebrandt I report.

[4] *Impacts of Market Power in California's Wholesale Energy Market: Results of More Detailed Analysis of Individual Seller Transactions in ISO and PX Markets*, prepared by Eric Hildebrandt, Manager of Market Monitoring, April 2001 (the "Hildebrandt II" report)

[5] In the Hildebrandt I report, the total potential impact of market power in California's wholesale markets were estimated by extrapolating results of this analysis to the entire ISO system based on hourly system-level schedules, loads and prices. With this "top down" approach, the total revenue impact due to differences between actual market prices and the competitive baseline prices was estimated by simply multiplying these price differences by the total quantity of system load not met by UDC generation. In the Hildebrandt II report, each individual transaction or schedule in the ISO system was used to calculate the excess revenues earned due to actual market prices in excess of the hourly competitive baseline prices developed as part of a previous DMA filing with the Commission. As shown in this report, results of this more detailed "bottom up" approach and the "top down" approach yield very similar estimates of the total economic impact of uncompetitively high wholesale energy prices. However, the more detailed approach used in this study allows an accounting of these impacts in terms of excess revenues earned by each supplier due to uncompetitive market outcomes.

markets. Of that $4 billion, approximately $3.1 billion is attributable to FERC jurisdictional sellers, with $1.8 billion occurring before October, and $1.3 billion occurring between October 2000 and February 2001. The remaining amount from within the PX and ISO markets ($870 million) is attributable to non-FERC-jurisdictional sellers, with $300 million occurring before October, and $570 million occurring between October 2000 and February 2001.

Approximately $2.7 billion of the $6.7 billion total represents energy scheduled outside of the PX and ISO markets (potential bilateral market activity and self-supply by non-UDCs, represented by final Hour Ahead Energy schedules submitted by different Schedule Coordinators). We do not have the data to distinguish between FERC jurisdictional and non-jurisdictional sellers in this segment of the market. However, we estimate that approximately $800 million occurred before October, and $1.9 billion occurred between October 2000 and February 2001.

Need to Examine all Excess Costs

In addition I would like to point out that the ISO believes the Commission should examine all excess costs, not just those that occurred after October 2, 2000. Specifically, when operating under a market-based regime, we believe that it is incumbent upon the Commission to order the refund of all profits attributable to the exercise of market power. To the extent that it can be demonstrated that market power was exercised prior to October, 2000, it is arbitrary and, in our judgment in violation of applicable law, to establish that as a refund cut-off date. In view of the DMA analysis, refunds must be ordered at least back to May, 2000.

Market Stabilization Plan

Finally, we would like to describe the ISO's proposed Market Stabilization Plan ("Plan") as presented to the Commission on Friday. The ISO has two main goals in developing and implementing the Plan: control the excessive and unreasonable costs being passed on to California consumers, and provide greater stability for ISO operations. To achieve the first goal, the market power of suppliers must be mitigated, and the ISO must have the authority to make the most efficient use of available resources. To achieve the second goal, the volume of real-time transactions to meet system load and ensure reliability must be reduced, by providing the ISO with the ability to commit and dispatch resources on a day-ahead basis. The Plan contains three major elements: the establishment of resource-specific cost-based bid caps ("RCBCs") for "Participating Generators" (those in-state generators that rely upon the use of the California transmission grid for the sales and transmission of energy), the establishment of new forward ISO markets for energy, and the establishment of an obligation that all Participating Generators bid available capacity into the ISO markets in exchange for a new Availability Payment to such generators. These elements are further described below:

Resource-specific Cost-based Bid Caps - The RCBC concept calls for all Participating Generators to be subject to bid caps based on each generator's incremental cost of production, including an additional amount to cover any revenue shortfalls due to modeling inaccuracy and to provide participation incentives. In a workably competitive market, it might be desirable to limit the RCBC price mitigation measure to narrow circumstances where the market is clearly non-competitive using some kind of market power trigger. There is ample evidence, however, that workable competition is not present in the California wholesale electricity markets. Moreover, the ISO anticipates that this summer, any kind of trigger for mitigation would be tripped at a high frequency. As a result, the ISO believes that the most prudent approach for the near team is to make the RCBC regime applicable to all ISO markets in all operating hours.

Forward Markets Paying RCBC-Constrained Market Clearing Price - The ISO would operate new forward day-ahead and hour-ahead markets for energy to cover the portion of the ISO's load that is not covered by bilateral contracts. These markets would fill the void left when the PX ceased operating similar day-ahead and hour-ahead energy markets earlier this year. The proposed ISO forward markets would pay suppliers a market clearing price that could be no higher than the highest Resource-specific Cost-based Bid Cap. With the bids from each Participating Generator set at a level that approximates its marginal cost of production, the resulting market would simulate the results of a highly competitive market - where each resource would be expected to bid into the markets at its marginal cost of production.

Generators outside the ISO control area would be able to bid a minimum price at which they are willing to be dispatched, and would be "price takers" whenever the cost-based market clearing price is above their bid price, but would not be able to raise the market clearing price above the highest cost-based cap. The ISO expects that the cost-based market clearing price will be high enough during high load hours to be sufficiently profitable to many outside suppliers.

Availability Requirement and Capacity Payment - Each participating generator would be required to have standing bids with the ISO for all of their available capacity. The ISO would thus have the right to dispatch a participating generator's entire capacity to meet system load. In return, each participating resource would receive an annual availability payment designed to permit recovery of its going-forward fixed costs. California is unique among restructured electricity markets in that there is currently no explicit obligation for generators within the California ISO's control area to satisfy demand in that control area except when necessary to prevent a system emergency. The Plan is designed to provide California with the same type of tools to satisfy demand within the control area as are available to the Eastern ISOs. Details of our Plan can be found in our April 6th filing with the Commission.

To conclude, in almost every appearance before a body such as this over the past year I have said that the operational difficulties confronting the ISO are unprecedented. Over the past few days and weeks, they have become even more so. However, I continue to take comfort in our excellent professional staff. If any staff is up to the challenge, it is mine. But we will need help, in addition to the enormous help we are receiving from agencies of California. We will need help from our neighbors in the region, and we will need help from FERC. As the need for assistance becomes clear, I will not hesitate to come knocking on doors. The health and well-being of the public -- across the entire western United States -- requires no less.

Thank you for this opportunity to present the views of the California ISO. I would be glad to answer any questions the Committee may have.

Mr. MAKOVICH. Thank you. When California passed its restructuring laws 5 years ago, it set a goal to move from regulation and toward the market. California would still benefit from a move to a market that works. Unfortunately, the power market in California was set up with serious structural flaws right from the start. These flaws made it neither possible nor profitable to build power plants when needed. These flaws were a siting and permitting process that creates costly and time-consuming barriers to new power plant development; a power market that paid generators to utilize their power plants, but did not pay them enough to have capacity in place to meet peak demand and retail prices that were delinked from wholesale prices. And by disconnecting the demand side from the market, it put utilities in an unsustainable position that has resulted in bankruptcy and supply reduction.

The flawed market design was the first problem, but an even greater problem has been the complacency demonstrated when the evidence that the market flaws were playing out and creating a shortage. In answer to Congressman Burton's question, "Was there evidence that this shortage was happening?" The answer is clearly yes. The California economy grew 32 percent over the past 5 years, electric consumption grew 24 percent, and power generating capability declined. No one did anything year after year, while the State failed to site and permit the 1,200 megawatts needed each year to keep supply and demand in balance.

California ran out of capacity because it never set up a market to supply it. From 1996 through 1999 the California power market passed from supply surplus, to supply and demand balance, to a supply shortage, and the market clearing prices in California were clearly too low to support enough timely investment. California made a deliberate mistake to expect that the energy market alone, through either spot prices or energy contracts, would keep power demand and supply in balance in the long run. No other power market set up around the world relies solely on an energy market. California's energy market, as set up, did the job it was supposed to do. Prior to the shortage, the energy market was very competitive, paid generators to utilize their power plants efficiently, kept supply and demand in balance in the short run. But to do this, it had to clear on variable costs alone. The average annual wholesale price for power ranged from $14 to $31 per megawatt hour from 1995 to 1999. This is a level that is half of what is necessary to support new power supply development.

Clearly the market needed to pay for capacity to provide an additional timely payment to attract investment; however, the majority of stakeholders who set up the rules in California decided not to pay for capacity as long as reliability is free. What needs to be done in California to solve the problem falls into two categories; short-run actions to deal with the crisis and long-run actions to fix the market.

In the short run, California needs to connect wholesale and retail prices. It needs to reduce power demand, and it needs to focus on developing new power supply. The question is, are there signs that things are being done? If 5,000 megawatts of diesel-fired generation is not being coordinated and plans being made to synchronize in that grid, there is clear evidence that the efforts needed to relieve this problem in the short run are not being done. Testimony has also made it clear that there needs to be flexibility in environmental regulations that are currently limiting power supply.

In the long run, California needs to fix its market. It needs to establish a capacity market by mandating a capacity requirement and enforcing a deficiency penalty. It needs to set and enforce target levels of siting and permitting for new power plants, and meet those year after year. And it needs to create an independent and expert board to govern the market rules.

The signs are again clear. California is doing only some of what needs to be done, and many current policies are not working. Keeping retail and wholesale prices delinked have led to bankruptcies, it has kept thousands of megawatts out of supply. Using the State's time and effort and resources to take over the transmission grid will further distort the market, and is taking the efforts away from increasing supply.

The Department of Water Resources moving to long-term contracts at the top of the market is a mistake. These contracts have allowed California to push the recovery of current costs into the future. California will regret signing these commitments in the years to come.

In addition, barriers to new supply remain. Even with all the attention and hoopla focused on new supply, we are looking at about 1,300 megawatts from last summer to this summer of new supply, which is just about enough to offset 1 year's growth. The Federal Energy Regulatory Commission is also making mistakes in the way it is setting price caps. It is creating the perverse incentive not to run power plants at peak demand.

California needs to realize it competes in a worldwide market to attract capital for power development. It has created a negative and hostile environment to that investment, and it is moving to a very expensive and expansive public power entity.

[The prepared statement of Mr. Makovich follows:]

Lawrence J. Makovich

Senior Director of Electric Power Research

Cambridge Energy Research Associates

Testimony to The Congress of the United States

House of Representatives

Committee on Government Reform

April 10, 2001

Sacramento, CA

When California passed its electric power restructuring laws five years ago, it set a goal to move from regulation and toward the market. California would still benefit from a move to a market that works. Unfortunately, the power market in California was set up with serious structural flaws right from the start. These flaws made it neither possible nor profitable to build power plants when needed. These flaws were:

- A siting and permitting process that creates costly and time consuming barriers to new power supply development.
- A power market that paid generators to utilize their power plants but did not pay them to have enough capacity in place to meet peak demand.

- Retail prices delinked from wholesale prices.

  Disconnecting the demand side of the market put utilities in an unsustainable position that has resulted in bankruptcy and supply reduction.

The flawed market design was the first problem but an even greater problem was the complacency regarding evidence that the power market was not working and creating a shortage. The California economy grew 32 percent over the past five years, electric consumption grew 24 percent and power supply capability declined. No one did anything while year after year, the state failed to site and permit the 1,200 MW needed each year to keep supply and demand in balance.

California ran out of capacity because it never set up a market to supply it. From 1996 through 1999 the California power market passed from supply surplus to a supply/demand balance and then to a supply shortage while market clearing energy prices in California were clearly too low to support enough timely investment. California made a deliberate mistake to expect that an energy market alone--through spot prices or energy contracts--would keep the power market in balance in the long run. No other power markets set up around the world rely on an energy market alone. California's energy market did the job it was supposed to do. Prior to the shortage, the energy market was competitive and paid generators to utilize power plants efficiently and thus keep demand and supply balanced in the short run. To do this, the market cleared on variable costs alone; the average annual price for wholesale power ranged from 14 to 31 dollars per MWH from 1995 to 1999, a level that is half of what is necessary to cover the cost of new power supply. Clearly, a capacity market is needed to provide a timely additional payment to attract investment and keep the market in balance in the long run. However, the majority of stakeholders who set up the rules for the California power market favored a market that only paid for energy and did not pay for capacity as long as reliability was free.

What needs to be done to solve the California power crisis falls into two categories—short run actions to deal with the shortage and long run actions to fix the market. In the short run California needs to:

- Include all wholesale prices in retail rates.
- Reduce power demand.
- Focus on developing new power supply.

- Create flexibility in environmental regulations that limit power supply.

In the long run California needs to:

- Establish a capacity market by mandating a capacity requirement and enforcing a deficiency penalty.
- Set and enforce target levels of annual siting and permitting for new power plants.
- Create an independent and expert board to govern market rules.

California is doing only some of what needs to be done and many current policies are not working. Keeping retail and wholesale power prices delinked drove PG&E into bankruptcy and is keeping thousands of MW of supply out of the market due to non-payment for production. Further, instead of using the state resources to develop new power supply, the state is spending time and money trying to take over the transmission network. Similarly, using the Department of Water Resources to sign long-term energy contracts at the top of the market is also a mistake. These contracts have allowed California to push recovery of current power costs into the future. California will regret signing these commitments in the years to come. In addition, barriers to new supply remain. Even with all the attention focused on expedited approvals, California will add only about 1,300 MW from last summer to this summer, an amount of supply that just meets one year of growth in demand.

The Federal Energy Regulatory Commission is also making a mistake by setting its wholesale price caps on the basis of the average monthly variable costs of the most inefficient generating units. This policy distorts the market by giving these units the perverse incentive not to operate when needed at time of peak.

California must realize that it competes in a worldwide market to attract power development. California remains a hostile investment climate for power developers. The market is still set up such that the only way to recover power investment is through brief periods of a shortage induced price spike. However, if you invest on this basis you are likely to be vilified as a price gouger. California is at a critical juncture—it can fix it power market or move toward an expensive and expansive public power sector. Other states have set up power markets successfully and

California would be better off following these examples and fixing its power market.

Mr. OSE. Thank you, Mr. Makovich. I would like to recognize Congressman Horn to initiate questions for 10 minutes.

Mr. HORN. Just a few to clarify a few things. President Lynch, as chairman of the California Public Utilities Commission, I am sure you did look at this whole situation over time. Did you ever work for the California legislature at all?

Ms. LYNCH. I did.

Mr. HORN. You did? Was it at the time they were talking about deregulation?

Ms. LYNCH. No.

Mr. HORN. When did they first discuss deregulation?

Ms. LYNCH. Well, they passed the bill in August 1996. I believe they were talking about it for a while before.

Mr. HORN. Right. And as I remember, Steve Peace was the leader of that.

Ms. LYNCH. I believe that Senator Brulte is the author of the legislation.

Mr. HORN. Really? Well, I guess everybody else saw it as Peace, who was a Democrat, and every single Member, Democrat and Republican, voted for that, I believe, as I remember the vote.

Ms. LYNCH. I was not there.

Mr. HORN. OK, you were not there. Well, Mr. Chairman, let us get what the truth of it is in the record at this point as to did they all agree to it or did they not. But as I remember, they all agreed to it on deregulation.

Mr. OSE. If the gentleman would yield.

Mr. HORN. Yes.

Mr. OSE. It is my understanding that AB1890, which is the legislation that implemented the restructuring, was at least in part authored by then Assemblyman Brulte, and that Senator Peace carried it in the Senate.

Mr. HORN. OK.

Mr. OSE. And, that it was adopted unanimously.

Mr. HORN. And it was adopted.

Mr. OSE. That is my understanding.

Mr. HORN. That is right.

Mr. OSE. We can check it out.

Mr. HORN. So, that is one thing to clarify. Let me ask you about the situation, and we have a letter here from the law firm Swidler, Merlin, Sherif, Friedman in Washington. Is that a representation of the public utilities? I am just curious. We have a letter from them, and I just wondered do they speak for the California Public Utilities Commission?

Ms. LYNCH. No, we have our own independent legal staff.

Mr. HORN. In Washington?

Ms. LYNCH. No, in California.

Mr. HORN. I see.

Ms. LYNCH. And we have——

Mr. HORN. Because we are talking about the Federal side, and I just wondered if you kept counsel on the Federal side.

Ms. LYNCH. No, we have State employees who are lawyers, who represent the California Public Utilities Commission in Washington at the Federal Energy Regulatory Commission.

Mr. HORN. But, let me tell you what worried us, the $6.7 billion were presumably potential excess cost. Now, the fact is, when you put all the figures out, you are talking about 6.7 total overcharges for the independent systems operator, and the power itself, including ancillary services, from May 2000 until February 2001, that is 8 months. And $4 billion of the $6.7 billion is from that, say a lot of people. I would like to know what Mr. Winter says on this. $3.1 billion is from the Federal commission and jurisdictional sellers, and then $1.3 billion occurred between October 2000 and February 2001, and that was several months. Mr. Winter, could you untangle this as to who did what to whom, and what it boils down to?

Mr. WINTER. OK. So that it is clear, Swidler is the representative of the ISO in Washington, DC, and does our filings with them.

The report you are referring to was our comments to the FERC market monitoring program. If you look at the numbers, the first thing we were asked to do was to look at the total wholesale energy cost, excluding the utilities. And of that, we found that there was about $6.2 or $6.7, whichever number you referred to, that was what we would consider to be what you would expect if you had a working market. In other words, if you had a market that was working, and had hourly prices, you would expect a certain price. The price that Californians paid was $6.7 billion above that number.

Now, that number is made up of several components, one of those being bilateral contracts that we do not have any knowledge of exactly what is included in those. So that is of the total savings, about $2 billion was extrapolated from what we saw in the market, which leaves us the $4 billion that is over—you used the term "overcharged." I would say above market prices. Of that, a portion was the PX, part of it was the ISO real-time, and part of it ancillary services. The PX energy we have a good feel for, because as they were running, they had rates that were open to us, and so we could review those.

If you then break that $4 billion down, it amounts to approximately $3 billion that is in the jurisdiction of FERC, and about $1 billion that is non-jurisdictional. OK, now, if you go to the timing, because there was a lot of debate over when FERC could or could not do certain things, and if you look at the timeframe from May through September—and May is when we saw the cost start to go up—May through September, FERC jurisdictional was about $1.7 billion. FERC jurisdictional for the months of October through February was $1.3 billion, for a total FERC jurisdictional for that timeframe of $3 billion. So, I can submit this document. It is all in the report. And I assume that is what you are reading from those.

Mr. HORN. Well, that is right. It seems to me that $1.3 billion occurred between October 2000 and February 2001, and you say that is accurate?

Mr. WINTER. Yes.

Mr. HORN. OK. Is there anything here that is not accurate? Because one thing is that the Federal commission has a very small role compared to the State commission.

Mr. WINTER. Well, I would not classify it as not accurate. The one we do not have information on are the bilateral contracts that are done outside of our knowledge.

Mr. HORN. Now, who would know what those contracts amounted to?

Mr. WINTER. The entities who entered into them, which were the generators and the utilities, and later on, of course, the Department of Water Resources.

Mr. HORN. Well, did they file a document anywhere?

Mr. WINTER. Not that I am aware of, but I would not be the expert on that.

Mr. HORN. Well, between the two of you, you ought to know whether it is Federal, State, or what. Or do they have to do anything? It just seems to me somewhere a regulatory commission ought to know what those amounts were.

Mr. WINTER. I would assume that FERC can get that information, but we do not have it.

Mr. HORN. Well, how about it, Mr. Madden?

Mr. MADDEN. Well, Congressman Horn, you asked a very interesting question. The six point——

Mr. HORN. Usually when somebody says that, I give them a "C" as a student. So, as a former professor, is this going to be more than interesting? [Laughter.]

Mr. MADDEN. It is going to be more than interesting.

Mr. HORN. OK, that is what we want.

Mr. MADDEN. Using the $6.2 billion that the ISO submitted, I think around March 22nd, as a basis for people to read as excess refunds due consumers is somewhat shaky. We asked the ISO last week to provide us the details. What you have to understand is that the $6.2 billion covers a period from May 2000 through February 2001.

Mr. HORN. Eight months.

Mr. MADDEN. It also includes non-jurisdictional money. And those are sales made by municipals or co-operatives such as Sacramento Municipal Utility District or Los Angeles Ddepartment of Water and Power or Federal Power Marketing administrators in the northwest, or other entities over which we do not have jurisdiction. We find for the first time that approximately $2 billion is associated with bilateral contracts, which is not subject to our refund order. We were dealing with a realtime market.

So, Congressman Horn, to get to the bottom line, FERC asked the ISO to provide us the detail necessary to explain why or how they arrived at the $6.2. Today, for the first time they are trying to carve out the $6.2 billion. We can require the jurisdictional sellers—the jurisdictional sellers and the public utilities—to provide us that information. We have sent a data request to the ISO to provide us that information relative to both the jurisdictional and non-jurisdictional.

Mr. HORN. So you have no problem with asking for those bits of information?

Mr. MADDEN. I have no problem at all, sir.

Mr. HORN. OK. Do you think the State commission ought to do that, also?

Mr. MADDEN. Well, these are wholesale costs. They will be submitted to us. Of course, the California Public Utility Commission can provide its response, and I believe it has to some extent with respect to the ISO filing. But they are welcome to provide the comments, once the ISO provides us with the information we have requested.

Mr. HORN. President Lynch, is your Commission going to ask for the ISO information?

Ms. LYNCH. We do have the ISO information. I applaud Mr. Winter's cooperation, now that we have new members of the board who are not stakeholders and not self-interested in the board. We had quite a bit of trouble, as an entity of the State of California, obtaining basic information from the ISO and the sellers in the fall, and we had to apply to FERC for help in getting that information, but we did not receive that help. But now that we have disinterested members on the ISO, after the Governor and the legislature changed State law, we have had much more cooperation.

You noted, Congressman Horn, that the FERC has a small role. Actually, I think the FERC has the whole ball game because they control wholesale prices. We can ask for the information, and fight in court with the generators over receiving it, but we cannot impose price rationality in the system. That is entirely FERC's jurisdiction as the Federal regulator.

Mr. HORN. Is that correct, Mr. Madden?

Mr. MADDEN. We have total authority over the wholesale rates, that is correct. We have requested that information from the ISO, and if we do not get the full details, we can and will request the information from the individual generators to the extent they are jurisdictional.

Mr. OSE. Well, would you yield for a minute?

Mr. HORN. Yes.

Mr. OSE. Well, let me just—let us just jump in here. Mr. Winter, can you give the information to Mr. Madden, so we can cut this out?

Mr. WINTER. Yes. I find this very interesting, but I will not comment on that. Yes, they have the information that we have. The interesting thing is that we have no authority to get from the generators what their actual costs were, so all we can do is present to FERC our suspicions. Now, FERC is the one that has the authority to go to the generator and say justify your rates.

Mr. OSE. OK, so we can get the information that you have to Mr. Madden?

Mr. WINTER. That is no problem. It has already been submitted.

Mr. HORN. And then I think President Lynch was going to note something here. You started a breath there, and I assume that is a paragraph, so what is—well, how do you feel about that?

Ms. LYNCH. I think the important conclusion is that the ISO, using all of the information that was available to it, under the most conservative assumptions, found that the sellers overcharged Californians over $6 billion in less than a year. You know, in 1999, California paid $7.4 billion for power—for electricity. In 2000, we paid over $27 billion for electricity. That is $20 billion more in just 1 year for a 2-percent increase in demand. And to paraphrase David Freeman, even a blind pig can figure out that there is price gouging in that kind of market. But it does fall to FERC to demonstrate—to identify the gouging.

Mr. HORN. You mentioned stakeholders, and how they have gone down to five from what you called, interested parties. Tell me about how that worked. Did you make recommendations to the Governor and advise him that, look, these people are just doing something for themselves?

Mr. OSE. Mr. Horn, could we have a second round of questions?

Mr. HORN. OK.

Mr. OSE. All right. We will come back to that. I would like to recognize Chairman Burton for 10 minutes.

Mr. BURTON. Do you have the information from the generators that Mr. Winter alluded to?

Mr. MADDEN. I do not know all the information that Mr. Winter alluded to. We have requested information from the generators from the January-February period in which we established a $124 million refund. We asked them to provide us with the cost data or accept the refund numbers. As to the October-November period, we have sent out a data request to the generators asking for cost data.

Mr. BURTON. Well, how long do you give them to get that information back?

Mr. MADDEN. Seven days in one case.

Mr. BURTON. Seven days?

Mr. MADDEN. Seven days.

Mr. BURTON. And when did you send the request out?

Mr. MADDEN. We sent the request out for the October-November period last week.

Mr. BURTON. Why did you not do that before that?

Mr. MADDEN. The December 15th order that the Commission set which established the section 206 procedding required us first to look at the January to April period where we established the break point—a $150 review for megawatts. So, we focused on that first. We are now turning our efforts to the October-December period.

Mr. BURTON. It seems to me—of course, I am a novice at this—that you ought to kick it into high gear and get that.

Mr. MADDEN. Mr. Chairman, we are. We just had different rules apply in that period.

Mr. BURTON. We will talk to the head of the agency and find out why this is not getting done quicker. I mean, there is a problem out here that needs to be solved, and I think there is enough blame to go around.

Ms. Lynch, you said, or maybe it was Mr. Winter that said that there was anticipated a shortfall peak in June of around 3,700 megawatts.

Mr. WINTER. That is correct.

Mr. BURTON. Is that right? And that it might go down to 600 megawatts shortfall around September.

Mr. WINTER. Correct.

Mr. BURTON. Have you taken into consideration the 5,000 megawatts that could be produced through diesel power that is supposedly sitting around someplace in this State?

Mr. WINTER. Yes, that number was a little bit of a surprise to me. I was——

Mr. BURTON. Why is it a surprise to you?

Mr. WINTER. Well, because I know that there is generation, but we do not look at emergency generation.

Mr. BURTON. Why?

Mr. WINTER. Well, for two reasons. No. 1 is the operator. Let us say you have a hospital that has a 50 megawatt—or let us say it is a 10 megawatt generator. That generator only serves the operating room. And so——

Mr. BURTON. Excuse me. Let me interrupt. It just seems to me that, under the circumstances that you face here in California, you would get on the stick and find out where all that emergency power is so it could be utilized as quickly as possible when an emergency arises. And to start saying that you have not done that or you have not checked, you do not know what hospital is doing it and all those other things—now, obviously the hospital is going to use it for their own purposes in the event of a blackout. But according to the people we had on the previous panel, there is 5,000 megawatts of power out there someplace that could be utilized, and when I look at what you are looking at here next year or this summer, you are 3,700 megawatts short. And you do not even know if that 5,000 megawatts is going to be figured into the equation. If that is out there, then you have got a problem that can be solved. If it is not, then you can do something else. But, you cannot tell us anything today.

Mr. WINTER. Well, what I can tell you is that even if you could identify 5,000, it is my belief that the majority of it would never be turned on because what the entity who has that generation would have to do is shut off half their business while they turned on just the emergency operating room.

Mr. BURTON. But, how do you know that?

Mr. WINTER. Well, because I have been in the business for 40 years and I know——

Mr. BURTON. But have you looked into it? I mean, have you really done an analysis of it.

Mr. WINTER. Well, no, we have not done an analysis.

Mr. BURTON. Well, do you not think you should?

Mr. WINTER. I believe that the Energy Commission is looking at those numbers, as is the Governor's people, and when they identify how many megawatts are there and we can identify how many could actually solve the problem as opposed to not solving it, then we certainly would figure that into our equation.

Mr. BURTON. I do not know how everybody else feels, but I feel like everybody is pointing the finger at somebody else, and everybody is not doing the things that ought to be done to make sure that they have a complete analysis of where energy is, where alternative sources are, so they can get the job done, if possible, with what is out there. And you really do not know where the 5,000 megawatts they alluded to in the previous panel are. You say that it is probably in hospitals and every place else, but you really do not know.

Mr. WINTER. That is correct, I have not looked at it.

Mr. BURTON. But you will try to find out?

Mr. WINTER. Certainly.

Mr. BURTON. Do you know how long that will take?

Mr. WINTER. Well, I think the information resides in the Energy Commission, and so we will go——

Mr. BURTON. Can you talk to them tomorrow and find out?

Mr. WINTER. I can talk to them tomorrow.

Mr. BURTON. That would be great.

Now, let me just ask you a question, Mrs. Lynch. Last summer, according to the records here, in April it was $26.56 per megawatt, right?

Ms. LYNCH. I do not know what you are referring to.

Mr. BURTON. This is the chart you gave us.

Ms. LYNCH. Right, that is the average chart from the PX.

Mr. BURTON. OK. So that is what it was per megawatt in May?

Ms. LYNCH. On average.

Mr. BURTON. OK. That was in April. And then in May it jumped to $47.22, right?

Ms. LYNCH. On average, that is correct.

Mr. BURTON. On average. Well, about that time you had an offer to buy electricity at 5 cents per kilowatt hour, you did not buy it. Why?

Ms. LYNCH. Well, the Public Utilities Commission does not buy power, the utilities do. What the Public Utilities Commission does do is authorize the utilities to buy power.

Mr. BURTON. Did you authorize it?

Ms. LYNCH. Absolutely. Since I have been on the Public Utilities Commission, the utilities have asked 10 times for authority for bilateral or forward contracts, or the authority to participate in hedging products. Every single time the Public Utilities Commission has allowed the utilities to do so.

Mr. BURTON. Well, why did they not buy the electricity or sign the long-term contract for 5 cents per kilowatt hour?

Ms. LYNCH. I do not know the offer you are referring to.

Mr. BURTON. You do not know?

Ms. LYNCH. I know that many offers were made at various points in time. I do not know a specific offer made in May of 2000.

Mr. BURTON. But looking at the jump, there was a quantum leap from April through—it almost doubled in May, and then it was more than double again in June, and then it continued up from there. What was the situation? We are going to talk tomorrow in San Jose to some of the utilities. But the reason they did not file for that was because there was so much interference from the staff at the Commission. That is not true?

Ms. LYNCH. All I know is, every single time they asked for authority, we gave it to them. And in fact, the facts show that——

Mr. BURTON. Did you give it to them in writing?

Ms. LYNCH. Oh, absolutely.

Mr. BURTON. Can I get copies of that?

Ms. LYNCH. Certainly. August 3rd we said you buy your full net short, your choice, your business decision, and the utilities in fact did purchase bilateral contracts. We moved with lightning speed. They asked us on July 21st for authority, and we turned it around in 2 weeks and gave them full authority 2 weeks later. Then they started to buy, and they bought in August, in September, in October, in November. So I believe it is a canard to say that we stood in their way, because the facts show differently.

Mr. BURTON. They were buying at what rate?

Ms. LYNCH. They were buying at whatever rate they chose.

Mr. BURTON. I guess I am missing something here. There was an offer for long-term contracts at 5 cents per kilowatt hour. And you are saying that they did not purchase it, they did not sign agreements for that. Why would they not do that?

Ms. LYNCH. No, that is, I believe, Mr. Chairman, what you said. I do not know the specific offer you are referring to, because the utilities receive dozens, if not hundreds of offers in a month.

Mr. BURTON. So, I need to address that question to the utility, themselves?

Ms. LYNCH. I believe so. What the Public Utilities Commission did was give the utilities the authority to expand their business choices. They expanded their business choices to the full limit, and the utilities actually took advantage of some of that authority.

Mr. BURTON. Well, there is a difference of opinion, and we will get their side of the story tomorrow. They have said that the problem was that they could not get through the red tape or could not get through the staff at your office. But we will check into that tomorrow.

I have more questions, Mr. Chairman, for the record. And I would like to ask some of those on the next round.

Mr. OSE. We will come back.

Mr. BURTON. Thank you.

Mr. OSE. Thank you, Mr. Chairman.

Mr. Winter, I want to examine something here that troubles me greatly. Ms. Lynch, in her written testimony, talks about a December 8th order that you obtained from FERC eliminating price caps. December 8, 2000, and describes it as a secret order. Is that an accurate description?

Mr. WINTER. I think that is a little over-dramatic, but——

Mr. OSE. How would you describe it?

Mr. WINTER. The way I would describe it is, on Wednesday of that week the prices—we have a situation where we had a price cap of $250. And what was occurring was that we quickly reached the $250, and people were then not selling us power until they would call us on the phone and say I am willing to give you the power, but the price is $300. When we make and go above price cap, what we are making is a bilateral agreement between the market and the ISO committed to that $300 price. We were completely inundated, because the price of natural gas at that time was rising to the $40, $50 at burner tip, and we could not get power into the system. So on Friday, what I did was, so that we could put these prices that we were having to pay under review of FERC, I did not remove the price cap, what I said was any money that we paid above the $250 price cap would now be subject to FERC review. Because I was already in the position that I was having to pay those to keep the lights on. So, that is what we did on the December 8th timeframe. We immediately filed that at FERC, and they turned that decision around that day and gave us authorization to make that part of our market.

Mr. OSE. Were there parties who were excluded from that process? I mean, I am trying to reconcile your statement with Mrs. Lynch's testimony.

Mr. WINTER. Yes, I think we moved extremely fast. There is no doubt about that. Because I was in a situation where I literally could not make the phone calls that I had to in the operating room, and I would not have had the power. Therefore, I made the emergency filing with FERC and enacted it the next day.

Mr. OSE. Mr. Madden, your recollection is consistent with that?

Mr. MADDEN. My recollection is almost consistent with that. They made an emergency filing on that day saying that they needed power and they could not get the power at the $250 hard cap. They asked for a soft cap, in which to bid the prices. We have authority, under section 205 of the Federal Power Act, to waive the notice of provisions in situations like this. The Commission acted very swiftly on the filing, very swiftly, and issued the order so that the ISO could get power that day and the next day.

Mr. OSE. Ms. Lynch, is it the word secret that is causing a problem here? Your testimony says that this was a secret order, and I am trying to find out how we get some collegiality, if you will, or call it whatever you want, in this process.

Ms. LYNCH. We found out about it after it happened. And as the head of an administrative agency, one process that I take extremely seriously is the requirement for public notice and comment. I think that is a fundamental tenet of due process that is required by the U.S. Constitution. And what happened there was a private entity, the ISO—actually the head of a private entity, without consulting or getting a vote of the board in a public process, went to FERC and privately asked for an emergency order. And FERC, without notice to a single California policymaker or elected official, granted that without the opportunity for anyone else in California to even comment, much less object.

Mr. OSE. How do you reconcile that situation with the Governor's refusal to disclose information on power contracts?

Ms. LYNCH. The difference is the FERC is required to act under the Administrative Procedure Act, according to its process. The Governor is—or the Department of Water Resources is essentially in a market where arbitragers have the technological capacity and the expertise to take advantage of small bits of information in order to disadvantage California ratepayers. So, if you are in a business transaction where you are bidding against a bunch of other bidders, you want to make sure that the other bidders do not know the terms of your bid, because then they can outbid you. Essentially, Department of Water Resources is now in the business of buying electricity, and in that business situation, you do not want to hand over all the cards you possess to your business competitors. The difference here with FERC was that they were acting in their administrative capacity as a regulator, yet they failed to follow even the basic tenets of due process or notice.

Mr. OSE. I cannot quite understand the difference, from a public policy standpoint, if you will, from ISO's action as you described, in a secret manner, that redounds to the adverse impact of California consumers and the inability of California taxpayers, from a public policy standpoint, getting information from the Governor's office about these contracts for forward delivery of power that uses taxpayer resources. I am afraid I am just a businessman, I am not an attorney. I do not quite understand the difference.

Ms. LYNCH. Well, certainly FERC failed to follow its Federal statutes and administrative mandates such that its action should be entitled to deference. Because if you fail to follow the process and do not allow any other comment, then your action should not be entitled to deference.

But as a business person, I am sure you know the cutthroat world of business when you are competing on a price point or on a term of a contract. Notwithstanding that, DWR does not have a statute in which it failed to follow in competing in the business world to get the best price for California consumers. However, DWR has said that when that information is no longer business sensitive, it will provide that information to the public. The problem here is why should we put all of our cards on the table and allow the same sellers, who have continued to gouge the California utilities, to gouge the State.

Mr. OSE. Mr. Madden, do you share the differentiation that Mrs. Lynch is describing here?

Mr. MADDEN. I do not share that differentiation, whatsoever, and I would like to correct the record. The Federal Power Act, section 205, gives us full authority to act on a filing such as the ISO made that day without notice and without opportunity to comment. We followed the statute. It was an emergency situation. The ISO needed additional power.

Mr. OSE. I want to move on to another subject.

Mr. HORN. Could I, before——

Mr. OSE. Certainly, Mr. Horn.

Mr. HORN. I would like to follow this up a little and get the public administration aspects of it. Mr. Winter, who appointed you to the position of independent system operator?

Mr. WINTER. That was under AB1890. It is a not-for-profit corporation formed under the authority of AB1890, and under the corporate laws of California.

Mr. HORN. And who appointed you?

Mr. WINTER. The board at that time.

Mr. HORN. Which board?

Mr. WINTER. We had a stakeholder board.

Mr. HORN. The original stakeholder board?

Mr. WINTER. That is correct.

Mr. HORN. And there were what, 28 people on it?

Mr. WINTER. 27, 28.

Mr. HORN. 27, 28. And the law then, which is a State law, had certain categories, I assume. Consumer, term——

Mr. WINTER. Yes. It was an attempt to be in a balance between consumers, suppliers, utilities, municipalities, generators, all of those were on the board.

Mr. HORN. Did the Governor at that time make all of those appointments, or did the board meet and make the appointments, up to 28 or so?

Mr. WINTER. The way the process worked was, the State appointed an oversight board, and it was their responsibility to take the candidates and approve those, and then those were sent on to FERC for approval.

Mr. HORN. So, in this case it was Governor Davis, was it, that put the people on——

Mr. WINTER. No, I believe that was done in the 1997 timeframe, the first board.

Mr. HORN. Well, is that Governor Wilson or who?

Mr. WINTER. I believe it was during that timeframe.

Mr. HORN. OK. Somebody has to appoint them if they are not voting each other in.

Mr. WINTER. That is correct.

Mr. HORN. OK. So that is the way it worked?

Mr. WINTER. Right.

Mr. HORN. The legislature passed a law. The sitting Governor complied with the law and put in certain people.

Now, the next Governor was worried, in the words of Ms. Lynch, with the interested parties maybe were too interested. So, they left five stakeholders there. And as I remember, he took the consumer person and left them there.

Mr. WINTER. Yes. Actually, the existing stakeholder board all retired, and the new board was appointed. Only one member of that new board was a past member of the old board.

Mr. HORN. And that was presumably the consumer representative; is that correct?

Mr. WINTER. That was the consumer representative.

Mr. HORN. Yes. The other four had no previous experience with electricity issues is what has been said. Is that true?

Mr. WINTER. I do not know whether they have experience with electric issues or not. Certainly they did not come from the energy side of the business.

Mr. HORN. Well, some think that when the Governor took everybody away except the consumer representative, that he brought on people in the middle of a crisis without any expertise to deal with it. Do you agree with that or what?

Mr. WINTER. No. I think the board's position is to rely on their staffs to get up to date, and this board clearly has spent the time and the effort to get current on energy issues.

Mr. HORN. So those staff members—how many staff members were there?

Mr. WINTER. I am not following staff members.

Mr. HORN. Well, how many staff members came with the stakeholders' board, with the legislation authorizing that board, and was that also the board members, or was it the Governor? Because obviously another Governor felt that they served at his pleasure, which is often the way Federal boards are in Washington. So I am curious who picked the staff.

Mr. WINTER. Well, when you say staff, the staff of the ISO?

Mr. HORN. That is right, the stakeholders' group and the ISO stakeholder board.

Mr. WINTER. Well, the stakeholder board picked the officers, who then, of course, selected the staff down through the organization. When the new board came in, it is their responsibility, of course, they had the choice of removing me, if that is what they wanted to do, and clearly they could change any of the staff people that they so desired.

Mr. HORN. Let me ask you, Ms. Lynch. Did you help staff the board, because you are very close to the Governor, obviously? So, who put the board together, and who put the staff together?

Ms. LYNCH. I run the Public Utilities Commission, which is a State entity. The Independent System Operator is a private, not-for-profit corporation which is not a State entity. However, the

Governor, under AB5X, which was passed in January, does appoint a financially non-interested five-member board. So, the difference there was that anyone who could have a financial interest or was employed by someone who could have a financial interest in the decisions made by the ISO could not then serve on the ISO board.

The Governor appointed five independent members of the ISO board pursuant to AB5X. One of them was Michael Kahn, who was the past chairman of the Electricity Oversight Board of the State of California. And I would take issue with Mr. Winter that Mr. Kahn has considerable energy expertise forged in the heat of the recent crisis, and certainly is one of the premier experts on this issue and on the failures of the restructuring experiment in California.

In addition, Mr. Guardino, who is the executive director of the Silicon Valley Manufacturers Group, I believe has made it a special expertise of his to understand just exactly how this energy crisis is affecting the Silicon Valley, and the key and critical component of California's business. So I think that Mr. Guardino also has considerable expertise, and I would take issue with Mr. Winter's statement.

Mr. HORN. I am curious, who is the chairman of that board now?

Ms. LYNCH. Mr. Kahn, who was the past chairman of the Electricity Oversight Board.

Mr. HORN. OK. Are we going to have Mr. Kahn somewhere along between San Diego, Silicon Valley, and Sacramento?

Mr. OSE. He was invited, but declined to appear.

Mr. HORN. Well, so much for open things.

Ms. LYNCH. I believe that Mr. Winter is appearing on behalf of the entity that Mr. Kahn is the chair of.

Mr. OSE. Would you yield?

Mr. HORN. Yes.

Mr. OSE. Mr. Madden, in terms of the replacement or the retirement, and the appointment of the new board for ISO, I heard that those appointments come to FERC. Did FERC have concerns about this based on this PX clearing price schedule? Did the FERC have concerns about what was transpiring?

Mr. MADDEN. The Commission's December 15th order set a date, and I do not recall the date, where the board that existed prior to this new board would have to be reconstituted. We set up a procedure to have discussions and negotiations with the State as to the board composition. I believe those discussions never took place; I believe the Governor appointed the five board members. I cannot get into the further details, because there are pending matters before the Commission regarding this subject.

Mr. OSE. OK. I see my time has long since expired. I would like to recognize the gentleman from Indiana for 10 minutes.

Mr. BURTON. Let me go through some of the questions that we have prepared for the record. And if I am redundant, I apologize, but we need to get these in the record so we, when we get back to Washington, can go through this very thoroughly.

Mr. Winter, you said on an average summer day the level of demand varies, but it gets up to, you anticipate, around 3,700 megawatts short. Now, what is the total megawatts on a summer day?

Mr. WINTER. On a summer day, with a normal summer, we get up around 47,000 to 48,000, and when you add reserves our demand is around 50,000 megawatts.

Mr. BURTON. Around 50,000 megawatts. And that is the peak?

Mr. WINTER. That is the peak.

Mr. BURTON. And then it goes down, I guess, after June or July?

Mr. WINTER. No, no. What happens is, when we get to July there is new generators coming on, so therefore the peak day stays pretty much at the 47,000 or 48,000 level, and as we add more generation, then, of course, our deficiency decreases.

Mr. BURTON. OK. Now, this summer what do you anticipate the supply level to be? You said it would probably be 3,700 megawatts short. But what will the level be this summer? You said the demand would be around 50,000.

Mr. WINTER. Correct.

Mr. BURTON. What is the supply going to be? Do you have any projections on that?

Mr. WINTER. Well, the supply is made up of a lot of components. First is in-state generation, then there is out-of-state generation that we can get.

Mr. BURTON. I just want a number. [Laughter.]

Mr. WINTER. Well, and I guess I am a little struggling on what you mean by a number.

Mr. BURTON. Well, if you are going to need 50,000 megawatts, do you have any idea on how much you are going to have?

Mr. WINTER. Yes, 3,000 less than that.

Mr. BURTON. So 47,000 megawatts?

Mr. WINTER. 47,000.

Mr. BURTON. That is very good. [Laughter.]

OK. If a few key plants have breakdowns this summer because they are old and have been running at full capacity, what will that do? Do you have any projections on that?

Mr. WINTER. Yes. We have projected about 2,500 megawatts that would be off for emergency reasons, breakage, etc. If that suddenly was much higher, then the number would go up and we would be looking other places to try and obtain the power.

Mr. BURTON. And you do not have any idea what the odds are that would happen?

Mr. WINTER. Well, last year we saw numbers ranging from around 1,800 up to around 2,800 during the summer.

Mr. BURTON. So, you think that the 2,500 is a fairly good projection?

Mr. WINTER. We think that is a fairly good number.

Mr. BURTON. How frequently do you think California is going to have blackouts this summer? Do you have any rough idea on that?

Mr. WINTER. No. I keep hearing all these numbers that supposedly we came up with, but we in fact did not come up with them.

Mr. BURTON. Well, do you have any idea?

Mr. WINTER. No. No, we do not.

Mr. BURTON. So, you are just kind of driving in the dark?

Mr. WINTER. That is the way we have been driving for quite a while each day.

Mr. BURTON. Mr. Makovich, do you agree with that?

Mr. MAKOVICH. Well, 2 months ago in a study that we released on the California crisis, we did some fairly extensive computer simulation of this marketplace. Given the expected conditions for this summer, normal weather, a soft economy, 1.5 percent growth in real GDP, an 8-percent outage rate on thermal plants, 80 percent of normal hydro, we are expecting 200 hours when there is no margin at all, and 20 hours of rolling blackouts because the shortage is greater than 4,000 megawatts.

Mr. BURTON. Now, over what period of time would the 20 hours of rolling blackouts be?

Mr. MAKOVICH. That will be concentrated around the peak demand period, which is going to be that August-September timeframe.

Mr. BURTON. So you are talking about in a 24-hour day, there will be 20 hours of rolling blackouts? Is that what you are talking about?

Mr. MAKOVICH. Across that timeframe it will be necessary to institute a rolling blackout probably in southern California because of the load patterns for a cumulative outage across the summer of 20 hours.

Mr. BURTON. If I was a farmer, a milk producer like the gentleman who was here awhile ago, I would want to have some kind of a heads-up on when rolling blackouts were going to take place. Is there any prospects of that, to let them know when there is going to be a blackout. I was having dinner with some people the other night and right in the middle of dinner everything went black. There was no warning, whatsoever, and the whole area was black. So I just wondered, is there going to be any——

Mr. WINTER. Was that in California or Indiana?

Mr. BURTON. It was California. [Laughter.]

It was near Carmel.

Mr. WINTER. OK. Let me quickly tell you the process that we go through, and then I think that will answer the question. No. 1, if it is a distribution system problem that a transformer in your front yard blows up, then yes, that has happened and you are out of power.

Mr. BURTON. Sure. That happens everywhere.

Mr. WINTER. As the transmission operator, as we move into the morning we make all of our projections, and we go through a three-stage process. We start off with a stage 1, and that usually indicates that we do not have enough resources to cover our full reserves.

As we eat into our reserves, we get to a stage 2, which is less than 5 percent reserves, and then a stage 3. When we announce a stage 3, that means that we in fact are moving into an area where we expect to drop load.

There is notifications that go to each of the utilities. The utilities, in turn, notify their customers. And I believe—and Loretta can correct me if I am wrong here. I think they also just recently passed that the utility had to give each of the blocks, which is a certain amount of load that is going to be dropped, a notification if they are next on the line. The utility——

Mr. BURTON. How far in advance would that notification be given?

Mr. WINTER. Well, we are in an hourly market, so things can happen within the hour. We warn people early in the morning through the stages and through the notification of the PUCs.

Mr. BURTON. I understand this explanation you are giving, but how much time will people be given before there is a blackout?

Mr. WINTER. If the blackout is because we have identified there is—and I am not trying to be evasive here, I am just trying to help you understand what we face every day. And that is that if we know, we send the warnings out. But literally in the hour that it can occur, we will not know until about 30 minutes before that hour begins. Then, if we are faced with the loss of a large unit like we were the other day, then that drops to, you know, 15, 20 minutes is all the notice we can give because we just lost units and did not have sufficient supply to meet the demand.

Mr. BURTON. You are talking about a transformer or something like that?

Mr. WINTER. Or a generator.

Mr. BURTON. Or a generator.

Mr. WINTER. I mean, we have a large generator that goes out——

Mr. BURTON. I was talking about in the normal course of things, the rolling blackouts because of shortages. In the normal course of things, not the emergencies, how much time will these people be given? Do you have any idea?

Mr. WINTER. The problem is, we are operating on such a thin margin here that we can predict immediately or in the morning that we are going to have plenty of supply, but then we lose a unit. You are calling that an emergency; I call that an everyday operation, you know.

Mr. BURTON. OK. I guess I cannot get the answer to that one.

Ms. LYNCH. Chairman Burton, if I may.

Mr. BURTON. Yes.

Ms. LYNCH. The Public Utilities Commission did just change the standards, because you are absolutely right, people deserve to know. And even a half an hour's advance notice means you can turn off your computer, you can shut down your business process, you can make plans to run your backup generator. So, what the Public Utilities Commission said to the utilities is, you must notify in two ways. First, if you know that we are tight in the morning, then tell folks you are next up to bat, so that people can know during the day that there is a chance that their block is going down. And then second, when you know that block is going down, tell them in advance. The utilities get a half an hour's notice, and often the ISO has more notice. So, folks deserve at least a half an hour.

Mr. BURTON. I see. I understand. It just seems if there is even a remote possibility that there was going to be a blackout, you would give them the heads-up, and if it did not occur, so much the better.

Mr. WINTER. Right.

Mr. BURTON. Mr. Madden, in December FERC issued an order imposing what has come to be known as a soft price cap. If a generator charges more than $150 per megawatt hour, they have to file with FERC. Have you explained that yet, how that works?

Mr. MADDEN. I did not get into the breakpoint analysis, no. No, Mr. Chairman.

Mr. BURTON. Well, do you want to real quickly explain that so that we would have that on the record.

Mr. MADDEN. In the December 15th order, the Commission established, going forward from January 1, that there would be a breakpoint analysis in which sellers who bid in below 150 would get the market clearing price. So even if you bid in at 100, you would get 150. For those bids above 150, the Commission required that the sellers provide transactional data to support the basis of their bid.

Mr. BURTON. And how long does that take for that to be approved or disapproved?

Mr. MADDEN. We are required to issue—in terms of whether or not the refund obligation accrues as to those transactions, within 60 days at the most.

Mr. BURTON. OK. How did they arrive at this threshold of $150?

Mr. MADDEN. Prior to that period we had a soft cap effective December 8th because of discussions we had on the emergency filing with the ISO. Prior to that day, we had a 250 price cap. There was a concern the Commission addressed, that we will go do an initial screen, and they felt that 150 was an appropriate figure at that point for just an initial screen.

Mr. BURTON. So the goal of the soft price cap is to keep prices down?

Mr. MADDEN. Well, the goal——

Mr. BURTON. Is that the goal of it?

Mr. MADDEN. The goal is to provide the necessary supply where you need it, and at the same time review the transactions—the bids that come in—to ensure that the rates are appropriate. That was one of the key things we did in our March 9th order.

Mr. BURTON. So, you reviewed that. And the goal, then, ultimately, is to keep the price as low as possible?

Mr. MADDEN. Well, attracting supply, necessary supply.

Mr. BURTON. OK. And is that working?

Mr. MADDEN. It depends on what one believes is the appropriate price. We, in our March 9th order, determined from the January period that the appropriate price would be $273. At which point those transactions which occurred higher than that, the sellers would be required to either refund those moneys, or show that their actual costs were higher than that. And the basis for that is that we looked at the gas prices in January, which were $12.50 on average. We looked at the NO_x cost, which is $22.50, and we looked at the average pounds taken for a combustion turbine, and we arrived at a $273 price.

Mr. BURTON. If I might ask one more question. I will have more questions in the next round.

Mr. OSE. Certainly.

Mr. BURTON. Mr. Winter, you requested FERC's December order; is that right?

Mr. WINTER. Well, the December 8th order. The December 15th order was one that was a followup, I believe, to their November decision and was a final order in December?

Is that correct, Mr. Madden?

Mr. MADDEN. No, the November order was a draft order where we sought comments on the remedies proposed, and the December 15th order is the initial order, and that is on rehearing.

Mr. BURTON. So, you did order that December——

Mr. WINTER. 8th.

Mr. BURTON [continuing]. 8th order. Why?

Mr. WINTER. Well, as I explained before, I was suddenly——

Mr. BURTON. If I missed it, I am sorry. I do not want you to be redundant, but——

Mr. WINTER. Yes. I just explained that I had seen the prices go way above the price cap of $250, and I was not able to get power to serve the load.

Mr. BURTON. So it was an emergency?

Mr. WINTER. Yes.

Mr. BURTON. OK. I will come back for questions later.

Mr. OSE. I would like to followup on Chairman Burton's question—if I understand correctly, there has been a suggestion that your December 8th application to FERC for emergency increase in the price of power was inappropriate. My basic question is whether or not you had the authority to make that December 8th request to FERC. Did you have the authority to make that request?

Mr. WINTER. Clearly, under the other board, yes, I did.

Mr. OSE. What do you mean the other board?

Mr. WINTER. The Stakeholder Board that was in effect at that time. Anytime the market has a tremendous change—in other words, in 1998 we had a bid of——

Mr. OSE. My question deals more with procedurally. You were fully authorized under State statute to make that request of FERC?

Mr. WINTER. Yes, in emergency situations I have the authority to do that.

Mr. OSE. So nobody came to you beforehand and said do not do this? They actually said quite the opposite, they said we need to do this, or did you make that judgment?

Mr. WINTER. No, I made that judgment based on what was going on on the floor, and my inability to serve the load of California.

Mr. OSE. And that was well within your statutory authority under AB1890?

Mr. WINTER. I do not know what AB1890 says, but as the operator of the system, that is clearly in my authority. And under the FERC tariff, I have the authority to do that in emergencies.

Mr. OSE. OK. I want to recognize Mr. Horn for 10 minutes.

Mr. HORN. This is probably going over one of the colleagues here, but we might as well look at it. How vital is the open communication and cooperation between agencies? I would ask Ms. Lynch what tools does the California Public Utilities Commission use to communicate and coordinate efforts with other agencies, including the California Energy Commission? Is there communication, and what is their role in relation to your role?

Ms. LYNCH. Sure. The California Energy Commissionsites power plants, and also does research work on power trends, so they publish reports and such about consumption, supply, and power plants in California. The Public Utilities Commission regulates the investor-owned utilities in the provision of power in California. The Federal Energy Regulatory Commission regulates the wholesale price of power charged by the private generators who own power plants that are not utilities. We have quite a good working relationship with the other State entities in California that have jurisdiction over energy matters.

Mr. HORN. Does the California Energy Commission make recommendations to you on the need for power, or is that simply left for the community, the California Public Utility Commission that you chair?

Ms. LYNCH. No, the power siting—power plant siting authority resides in the Energy Commission. And the Energy Commission for decades participated in integrated resource planning, to plan out the power needs of the State. In the Wilson administration, the State stepped back and said the State is not going to take a look at the power needs overall in California. We will leave that to the market. So there was a dearth of planning and building for critical years in the 1990's. As the power consumption rose, the State stepped back, for ideological reasons, and that is one of the reasons we find ourselves in the pickle in terms of supply that we have today. Governor Davis stepped forward, and Governor Davis is pushing the private market to build those power plants, streamlining all the environmental regulations, getting every obstacle possible out of the way to get more supply, because for the past 8 years the prior administrations did not do the job to ensure supply for California. They let the market do it, and the market failed.

Mr. OSE. Would the gentleman yield?

Mr. HORN. Yes.

Mr. OSE. The California Energy Commission has a Web site, and on that Web site it posts its projections for power demand at some point in the future. These projections commenced being developed in 1988 for the year 2001. The projections by the California Energy Commission since 1988 have consistently shown a demand for power in excess of 50,000 megawatts. It is biannual. Every 2 years it updates the projections. So it has been a continual stream, we are going to need 51,000, 52,000 megawatts of power in the year 2001.

Mr. HORN. Now, let us say that the figure is right. What you are telling me is, it is a commission that is not doing much of anything. And could your own Commission be able to pass onsites? And I take it it does, does it?

Ms. LYNCH. Well, Mr. Horn, actually I am not saying that the Energy Commission is not doing anything. I applaud the Energy Commission's efforts over the past 2 years to streamline their processes. And, in fact, they have 16 plants through the permit process, and 9 of them—it might be 6, I am actually forgetting the number right now—are currently under construction. That is more plants under construction and permitted in the State of California in the past 2 years than in the prior two administrations combined. So the California Energy Commission is turning cartwheels to make sure we have got enough supply in California. The problem is, you cannot build a plant in just a couple of months. It takes a while to attract the investment, to get the folks to go through the process. They are going through the process now. The problem with it was in the past.

Mr. HORN. Just for the record, I assume all of Governor Davis's appointees are on the California Energy Commission? Those are pleasure appointments, are they, of the Governor?

Ms. LYNCH. No, they are term appointments.

Mr. HORN. They are term?

Ms. LYNCH. And he received his third majority appointment in January 2001.

Mr. HORN. What is the total number?

Ms. LYNCH. A total of five.

Mr. HORN. Five. So he now has a majority on that as of January?

Ms. LYNCH. That is correct.

Mr. HORN. OK. Now, what is the role, if any, Mr. Madden, at the Federal Energy Regulatory Commission? Do you also pass on some of these selections for sites and development of electricity and power?

Mr. MADDEN. The Federal Energy Regulatory Commission has no jurisdiction over the siting of transmission facilities.

Mr. HORN. That is just up to each State?

Mr. MADDEN. It is up to the particular States, yes.

Mr. HORN. OK. We are talking really about cooperation and communication with Ms. Lynch. The California Independent Systems Operator, Mr. Winter?

Mr. WINTER. Yes.

Mr. HORN. So do you talk to each other?

Ms. LYNCH. I think we do now more than we have in the past. Although this summer, when we had energy issues when there was a blackout on June 14th, Mr. Winter was quite helpful and cooperative. The problem really was the ISO tariffs, which prevented governmental agencies from getting the same information that market participants could get.

Mr. HORN. Chairman Burton noted that there is a lot of finger-pointing in all directions, and you are saying that you do not have that much finger-pointing unless you are perhaps here. I do not know. So here he is, and you can talk to each other.

Ms. LYNCH. And I certainly talk to the members of the board of the ISO on a regular basis. As you all know, as a private corporation in the State of California, it really does fall to the board to set the policy direction for the ISO.

Mr. HORN. Are you automatically, or the person in your position automatically a member of that group?

Ms. LYNCH. No, I am not at all.

Mr. HORN. You are not. So there is no linkage, generally. And it just has to be whether people talk to each other or do not.

Ms. LYNCH. I think that Governor Davis ensures that his appointees work together.

Mr. HORN. Yes. The California ISO, namely Mr. Winter, investigated evidence of market abuse—I believe you did this, is that correct—and reported its findings in a report issued in March 2001?

Mr. WINTER. That is correct.

Mr. HORN. And they project that power generators have overcharged California by $6.2 billion between May 2000 and February 2001. And, the Federal emergency commission determined that California was overcharged $1.3 billion. While some of the discrepancy can be explained by technical jurisdictional reasons, what are the other factors that contribute to such a large discrepancy?

Mr. WINTER. The other discrepancies between the——

Mr. HORN. The idea of $6.2 billion overcharged.

Mr. WINTER. Well, I think people have exercised market power and driven the prices up by so doing it.

Mr. HORN. You do not think it is the market that did it. I mean, in terms of the $6.2 billion, who came up with that? Apparently there are various other items that I noted earlier.

Mr. WINTER. Right. The way we arrived at the $6.2 billion is we would take a unit, much as the FERC had done, determine what its heat rates were, factor in the price of natural gas during this timeframe, factor in the cost of emissions, and arrive at what we call a cost-based rate. Then we allowed the market to have some bit of flexibility, and then everything above that which we are calling the competitive market price, we considered to be overcharge, if that is the term I believe you are using.

Mr. HORN. How about the Federal commission in terms of putting the pieces together on whether gouging occurred or did not occur?

Mr. MADDEN. Congressman, are you referring to the $6.2 billion?

Mr. HORN. Right, the $6.2 billion.

Mr. MADDEN. Well, as we——

Mr. HORN. Because that is the figure the public heard. That is why I am going after that.

Mr. MADDEN. As we discussed earlier, the $6.2 billion figure was that which the ISO submitted. As I recall now, the ISO recognizes that, of the $6.2 billion, a substantial portion of that is non-jurisdictional to FERC.

Mr. HORN. That would be the 47 percent that is non-jurisdictional?

Mr. MADDEN. I do not know what the numbers are. Another portion of that would be prior to October 2nd, 2000, in which the Federal Energy Regulatory Commission has no authority to require refunds pursuant to the November draft order and the opinion that is taken there. He also mentioned that a substantial portion—I do not know how much—referred to bilateral contracts or involved bilateral contracts. That is where you had a mutual agreement between the parties. That is not subject to refund. The realtime spot market is subject to refund.

He also mentioned how he factored in the cost, and he mentioned a thermal unit. We factored in, for the committee's information, a CT, combined turbines, which has a higher inefficient rate than does usually a thermal. He factored in gas costs and NO_x costs, but I do not, and this is why we requested information asking what those costs were.

Mr. HORN. Now, you get the Bonneville Power Authority records, I suspect, since that is a Federal entity. Do they file with you as to what they are generating?

Mr. MADDEN. Well, the PMA Bonneville is non-jurisdictional to us. It is a non-jurisdictional seller. Although, under a limited portion of the act, we can review the actual rates they charge in very limited circumstances.

Mr. HORN. Now, I take it that the municipal utilities such as those of the city of Los Angeles, Department of Water and Power, do you have or do not have jurisdiction over them?

Mr. MADDEN. We do not have jurisdiction over entities like that. We have no jurisdiction, for the most part, over municipals and co-operatives. If you look behind the $6.2 billion figure, a substantial amount of those alleged refunds or overcharges are associated with entities over which we do not have jurisdiction.

Mr. HORN. Would anything be in the Department of Energy where they might collect those records?

Mr. MADDEN. The U.S. Department of Energy has no jurisdiction over the co-operatives or municipals. It does have jurisdiction—or it oversees the Bonneville Power Administration—as it oversees the other power marketing administrations. You have to look at the organic statutes or the charters that created the co-operatives or municipals within each particular State.

Mr. OSE. Would the gentleman yield?

Mr. HORN. I was going to say the chairman is an expert on some of the figures of Federal dams, so you ought to put that in the record.

Mr. OSE. I actually want to followup on where you were driving as it relates to the municipals, in particular. I believe the ISO, on occasion, purchases surplus power from the municipals for distribution elsewhere.

Mr. WINTER. I am not sure what you mean by distribution elsewhere. But yes, to serve the ISO grid, we get power from Department of Water and Power clearly to distribute to other people in the State of California.

Mr. OSE. Now, we just heard Mr. Madden say that FERC has no jurisdiction over such entities. Would you kindly share with us your recollection of the prices being paid by the ISO for that power?

Mr. WINTER. From the Department of Water and Power?

Mr. OSE. As an example, yes.

Mr. WINTER. Well, clearly we were paying the market price to everyone, which at the point that we went over the $250 price cap, those would range all the way from $250 up to 5 or $600. I cannot remember exactly.

Mr. OSE. Who has jurisdiction over the prices charged by municipals selling into the wholesale market?

Mr. WINTER. I assume their governing agencies, be that a city council and Department of Water and Power, I would assume.

Mr. OSE. But they are not subject to FERC's jurisdiction?

Mr. WINTER. No, they are not.

Mr. OSE. They are non-jurisdictional. Ms. Lynch, are they subject to PUC's jurisdiction?

Ms. LYNCH. No. We have jurisdiction over the retail rates charged by investor-owned utilities, not municipal utilities.

Mr. OSE. From your recollection, Mr. Winter, of this report, did you break out, for instance, either in the aggregate or by individual municipal entity, how much of this $6.2 billion in overcharges were made?

Mr. WINTER. I believe there is a confidential attachment submitted to FERC, but I have not seen it myself.

Mr. OSE. You know, I am getting tired of being told I cannot have information. I suspect there are people in this State who share that opinion.

Mr. MADDEN. Mr. Chairman, I will be glad to provide that information. I assume, if it is cumulative data, we have to decide that issue in any event because we have the filing at the Commission, and we have to look at the——

Mr. OSE. You have to separate it out somehow.

Mr. MADDEN. We have to separate it out and compare it to what we have done, for example, in the March 9th refund order. So, I will be glad to provide the committee with that information.

Mr. OSE. We will be in contact with you.

Mr. MADDEN. Thank you.

Mr. OSE. I will yield back to the gentleman from Long Beach.

Mr. HORN. I yield back to you. I believe we have a third panel.

Mr. OSE. Yes.

Mr. HORN. OK.

Mr. OSE. I believe it is my 10 minutes?

I want to examine a couple of things, if I might. I want to go to the issue of long-term contracts, because it seems to me that the opportunity to hedge exposures, either by PG&E or Southern California Edison, or San Diego, offers the opportunity to effectively eliminate the uncertainty or the lack of supply that might otherwise occur. It is my understanding that AB1890 did not require the utilities to purchase all of their electricity through the PX, is that correct? Does anybody know the answer to that? There is no specific language in 1890 that says the utilities must buy from the PX.

Ms. LYNCH. I believe that is true. I believe that was the decision of my predecessors in order to create the PX and have it up and running, that they required the utilities to buy through the PX.

Mr. OSE. So, PUC adopted a rule that said investor-owned utilities must buy through the PX?

Ms. LYNCH. Yes, the past PUC.

Mr. OSE. The past PUC.

Mr. MADDEN. Mr. Chairman, they must sell into and buy from.

Mr. OSE. It is a buy-sell deal. Correct. Has this PUC ever examined whether or not to revoke that requirement?

Ms. LYNCH. Yes, we did.

Mr. OSE. And what was your determination?

Ms. LYNCH. At the time, based on conversations I had with Republican legislators who were active in creating the PX, they asked us to keep that buy-sell requirement.

Mr. OSE. Did you talk to any Democratic legislators?

Ms. LYNCH. I did, actually. I believe Senator Peace asked me to keep that requirement, as well.

Mr. OSE. So it was bipartisan?

Ms. LYNCH. At the time last—I believe it was June. Nonetheless——

Mr. OSE. I appreciate your making that clear.

Ms. LYNCH. Nonetheless, the PUC voted to allow the utilities to not buy and sell exclusively through the PX in June, and the legislature changed that in a bill at the end of June.

Mr. OSE. How did you vote on that issue?

Ms. LYNCH. I voted to keep the utilities buying and selling through the PX.

Mr. OSE. OK. So you were asking that, if you will, the transparency issue be maintained?

Ms. LYNCH. That is correct. And at the request of legislators who were there at the time AB1890 passed, with their understanding of what their intent was.

Mr. OSE. I will just come back to my earlier point. I do not understand why it is every time I ask about the PX or the ISO or something like that, I hear this mantra of disclosure, disclosure, disclosure. And yet when I ask the question and when my constituents ask me why we cannot find out what commitments the Governor is making of the State of California's treasury, I am told I am not qualified to hear that. Now, who is it that I have to ask to get that information? Does anybody know? Do I have to issue a subpoena from this committee to get that information?

Mr. MADDEN. Mr. Chairman, as I mentioned earlier, the Commission has asked the ISO to provide that information. If they cannot get that information, I can assure you that this Commission will ask the generators who have entered into those negotiations with the State to provide us with the information. I will have to go back and review the law, but I could probably provide that under confidentiality to the committee.

Mr. OSE. Do I understand these contracts that are being considered by the State of California to be long-term contracts?

Mr. MADDEN. As I understand it, and I am not an expert in the area, there is a combination of short-term, mid-term, and long-term contracts with different types of provisions.

Mr. OSE. So you have different exposure?

Mr. MADDEN. That is correct.

Mr. OSE. All right. Ms. Lynch, are those contracts subject to PUC review?

Ms. LYNCH. No.

Mr. OSE. Because?

Ms. LYNCH. Because AB1X transfers the just and reasonableness review of the power purchases to the Department of Water Resources from the PUC.

Mr. OSE. Who is held accountable for that decision? If the DWR makes a decision that something is unjust or unreasonable, or something conversely, at a price is just or reasonable, exactly how do the voters of this State hold someone accountable? Does anybody have the answer to that question?

Ms. LYNCH. The PUC does not have the jurisdiction to review that question.

Mr. OSE. OK. In terms of DWR's contracts?

Ms. LYNCH. That is correct.

Mr. OSE. OK. Let me go back to my original question. In March 1999, Southern California Edison filed with the PUC for authority to enter into bilateral contracts as part of a pilot program designed to provide market stability and increase supply. Now, if I am correct, that is prior to when you were made President of the PUC.

Ms. LYNCH. It is prior to my membership on the PUC.

Mr. OSE. OK. In July 1999, the PUC rejected that request from Southern California Edison because, in effect, as you said earlier, forcing the buy-sell transaction through the PX provides transparency, mitigates market power, and reduces regulatory burden. Now, since you have gotten there, Ms. Lynch, my question is whether you have any comments about forcing the IOUs into or through the PX, and the consequences of that requirement?

Ms. LYNCH. Well, the IOUs asked for additional authority to buy various hedging products that were available through the PX, and we granted that authority. And then, in addition, the utilities asked for additional authority to enter into direct bilateral sales only scheduled through the PX, but not purchased that way, and we granted that authority. So, from that perspective, the utilities had the full panoplies of tools in their toolbox to hedge their risk. I think what no one could have foreseen was the dramatic upward spiral of the market prices, as demonstrated by the chart in front of you that I have provided, because I believe no one could have foreseen that the price caps would have been blown out as they were.

Mr. OSE. I want to yield for a question from Mr. Burton.

Mr. BURTON. Yes. There was an article in the San Francisco Chronicle. I want to read you just a little bit of this and maybe you can explain this to me. It says, "On July 21st, Edison and PG&E filed emergency requests,"—this is last year—"with the PUC seeking authority to sign longer-term contracts directly with generators to protect themselves from surging prices. Their cause appeared to be bolstered by the August 2nd report that Davis,"—I presume the Governor—"requested from the PUC and the Electricity Oversight Board which clearly said the State spot markets were exacerbating price spiking, and that contracts between the utilities and power producers were needed. Sources say some State economists feared that signing a 5-year contract at $50 per megawatt hour could harm the economy. The day after the report was released, the PUC voted to let the utilities sign bilateral contracts through December 31, 2005 subject to a review of reasonableness. But the utilities now say that the vote was meaningless because the Commission's staff refused to preapprove contracts as reasonable after a 30-day review, as the Commission's order directed."

And what I have been told is that the utilities were very concerned because the contract—the long-term contract was subject to a review of reasonableness. So if they signed a long-term contract at $50 per megawatt hour, and the price on the spot market started dropping below that, they were locked into the $50 per megawatt hour, and they could be socked with a demand for return. And they did not think that was reasonable, because they were assuming risk, and if the price dropped they were up the creek, because they would have to refund a lot of money.

Why is it your office did not allow them to sign a long-term contract without subject to a review of reasonableness down the road?

Ms. LYNCH. Sure.

Mr. BURTON. For instance, I am a small businessman. I enter into a contract and they say it is subject to a review of reasonableness. And 5 years down the road, after I have signed the contract in good faith, they say you could have gotten it at $40 per megawatt hour. And then I am supposed to return that large amount of money, and it could cost me a ton and put me into bankruptcy.

So, why was that reasonableness clause not allowed to be taken out?

Ms. LYNCH. On a unanimous vote 2 weeks after the utilities asked for the authority to enter into bilateral contracts, the PUC did give the utilities the authority to enter into bilateral contracts, and then they entered into bilateral contracts. I am prevented, for confidentiality reasons, of telling the public exactly what they entered into, but I can tell you they entered into significant bilateral contracts. What the PUC did——

Mr. BURTON. It was a lot more, though, than the $50 per megawatt hour?

Ms. LYNCH. Some of them have been, yes.

Mr. BURTON. Well, but prior to that time, if that reasonableness clause had not been in there, they could have gotten it at $50 per megawatt hour.

Ms. LYNCH. And some of them they did, and some of them they did less than that. I cannot discuss the specifics, but it was a full range of prices. But I will——

Mr. BURTON. Excuse me just 1 second. The chairman of the subcommittees and the people who are watching are seeing that everything is under the veil of confidentiality. We cannot get this and we cannot get that. We represent the Congress of the United States and Federal agencies that participate in some of these processes. We want that information. And if I have to subpoena that information from you, I will do it. So, I want you to give it to us. Now, if it is something that should not be in the public domain, then we will honor that. But, we want to see that information. And to be pounded time and again after coming out here and having hearings, I do not want you to tell me we cannot have that information because of confidentiality. I want it.

Ms. LYNCH. I would be happy to give it to you if I had it. You can get it from the utilities. I, as a regulator, cannot give their confidential information without their permission. So I would be happy to give it to you confidentially. If you would like it out in public, you can ask them for it. It is theirs to give.

Mr. BURTON. OK. But I want to find out about this reasonableness clause.

Ms. LYNCH. Sure.

Mr. BURTON. You say that that reasonableness clause was done away with so that they could go ahead and enter into these long-term contracts without additional risk. But, what I have been told is that it was after the cow was out of the barn and the $50 rate that they could have gotten for long-term contracts was then going up, skyrocketing up. And if they entered into long-term contracts, it was at a much higher rate because you kept that reasonableness clause in there until the $50 rate was no longer available.

Ms. LYNCH. Well, the reasonableness clause is still in there, and they did sign contracts below $50 in some instances. But why we kept the reasonableness clause in there is because every other State also has a reasonableness review. That is the fundamental basis of a regulated entity.

You, as a small business person, do not get a guaranteed profit, which is what State law gives to the utilities. They get to recover their cost, guaranteed, no doubt about it. The only check on that cost recovery is a reasonableness review. And the Public Utilities Commission of the State of California had good reason to continue what every other State today still does, which is a historical fact pattern which showed abuses in the past between the utilities contracting with their affiliates.

Mr. BURTON. I understand. And there may be some justification for price gouging by the utilities. But the fact of the matter is, if you look back at the thing that you gave——

Mr. OSE. No, no, Mr. Chairman. You want to say there may have been some justification for the reasonable review due to——

Mr. BURTON. OK, due to. OK. [Laughter.]

But let us just take a look here. You could see from your chart here that the price per megawatt was jumping at a dramatic rate. And they were saying, you know, we can lock this thing in at $50 per megawatt hour, and because of this reasonableness clause in there, they were worried that they were going to really lose their shirt if they signed it at that time. And it seems to me that is something that was a reasonable thing for them to be concerned about.

Ms. LYNCH. Well, every State has a reasonableness review in order to protect the ratepayers, and as does California. What we did is not just for long-term contracts, it is a reasonableness in their actions, so that they do not go out and, you know, buy very expensive nuclear power that is 100 times what the original cost was because they have the guaranteed rate of return.

Mr. BURTON. Well, let me just make one more point. You did not work with them on this, and it seems to me you should have, and instead of being able to get it at $50 per kilowatt hour, in December it was up to $377 per kilowatt hour. So you could see from this chart that it went from $31.18 per kilowatt hour, up to $47.22 in May per kilowatt hour. And then in June it jumped to $120 per kilowatt hour. And the discussion, according to this article, was in July, after it had already jumped to over $120 per kilowatt hour, and they were trying to negotiate for $50 per megawatt hour. And you would not do it.

Ms. LYNCH. We did. We let them in 2 weeks time, which is lightning speed for the PUC. We gave them full authority up to their full average net short, and guess what, they actually contracted for power. What they did not do was fill up their full net short, because nobody was going to believe at the time that the FERC was going to blow out the price caps, and the average price of power every day of every hour in December was $378——

Mr. BURTON. Right.

Ms. LYNCH. [continuing]. After FERC blew out the price caps, and the generators had a field day with California's economy.

Mr. OSE. Mr. Chairman, may I reclaim my time? I would be happy to give——

Mr. HORN. I just have one question on this issue.

Mr. OSE. Certainly.

Mr. HORN. Is the California Utilities Commission under the Ralph Brown Act? Are you familiar with that?

Ms. LYNCH. The public process, yes. The Public Meetings Act, yes.

Mr. HORN. Yes. Well, the fact is that, sure, you do not make it public until the decision is made, but once the decision is made, you can answer the chairman's question. It is no violation of law that I am aware of under any State agency. So, why do you not answer him?

Ms. LYNCH. Oh, sure, all of our decisions are public, and they are public before we vote on them, as was our August 3rd decision which allowed the utilities to bilaterally contract up to their full power needs on average. And that is out there, and I would be happy to provide you—we can messenger it over right now with those decisions.

Mr. HORN. Well, but you were saying you cannot because of all the industry and such that. Once they are on the market and they have done it, you could have released that afterwards. I can realize you could not do it, because that might affect the market in another way, which is bonds, stocks, and so forth.

Ms. LYNCH. Well, the statute says that the utilities are entitled to keep the information confidential when they are buying and thereafter. For instance, they bought power ahead in the market. What disadvantages the utilities as a buyer is if I release how much power they bought, because then all the generators can figure out how much power is left that they need to buy. So if the utilities do not have to play all of their cards, then the generators do not know if they need to buy a lot or a little. So the generators, then, will bid more competitively if they do not know exactly the utilities' needs, which is why I cannot give to the public the utilities' business confidential data.

Mr. HORN. Well, I do not know why not, because now they are in bankruptcy and everything else. It seems to me it ought to all be on the record.

Ms. LYNCH. Well, if they would like to waive the confidentiality provisions, they can provide the data and I could then provide it to you. But right now, the way their business confidential data works, is because I have special access as a regulator to their business confidential data, I need to keep it confidential unless, you know, we have a prior conversation about that with the utilities.

Mr. BURTON. Will the gentleman yield to me?

Mr. OSE. I would.

Mr. BURTON. Mr. Makovich, as I understand it, and I think you are totally familiar with this, when they were concerned about this review of reasonableness, they wanted to have what, 20 percent as a percentage that they should be accountable for, and the Commission wanted only 5 percent, is that correct?

Mr. MAKOVICH. Outside of a reasonableness range, yes.

Mr. BURTON. Yes. OK, is 5 percent, as the Commission wanted it to be, a reasonable standard for this kind of a problem across the country?

Mr. MAKOVICH. No. Long-term power prices are very, very hard to predict, and to enter into a long-term contract of the type that have been signed, 4 to 20 years, that kind of a margin of error is far too low.

Mr. BURTON. What would be a reasonable margin of error?

Mr. MAKOVICH. Well, my testimony has been I think long-term contracts are not the right solution to this problem. They are not going to solve this shortage problem. There is a liquid futures market for power now that goes out about 12 to 18 months, so it is very, very clear what the market expectation is for power.

Mr. BURTON. And what is that?

Mr. MAKOVICH. Everywhere else in the United States it ranges from $20 to $30, depending upon the month, up to maybe $100. In California it is in the $300 to $500 range as we look out across the next year.

Mr. BURTON. I am not sure I understand that. Maybe I am missing something here. But as I understood it, the utilities, when they went to the Commission, wanted a 20 percent——

Mr. MAKOVICH. Right, reasonableness standard.

Mr. BURTON. [continuing]. Reasonableness standard.

Mr. MAKOVICH. Right.

Mr. BURTON. And 5 percent was what the Commission wanted.

Mr. MAKOVICH. Right. Even the 20 percent is probably a mistake.

Mr. BURTON. I understand. But the utilities were willing to do that. And because they could not get that, they did not lock in——

Mr. MAKOVICH. Right.

Mr. BURTON. [continuing]. The rate at $50 per megawatt hour?

Mr. MAKOVICH. Right.

Mr. BURTON. Why is it that the Commission would not go along with that 20 percent, which sounds like it is a fairly reasonable standard, instead of the 5-percent which they were standing fast on?

Ms. LYNCH. Well, as Mr. Makovich just demonstrated, many economists actually objected to our decision to give them long-term contracting authority on a bilateral basis whatsoever. So it was striking a reasonable balance at the time given the market, because many people, like Mr. Makovich, would probably criticize the decision of the Public Utilities Commission to give the utilities full-throttle ahead on buying whatever they would like to meet their next short. So, from that perspective, I think that the Commission probably went over what some economists thought was prudent at the time.

What we wanted to do was give the utilities the flexibility to run their business as they saw fit, and they did buy power at 5 cents, some less and some more over time. So I think that the assumption that they did not buy at all is actually not proven true by the facts. But the utilities have the specific facts that I would encourage them to share with you.

Mr. BURTON. We are going to talk to them tomorrow, I think. Is that correct?

Mr. OSE. Yes.

Mr. BURTON. OK. Thank you, Mr. Chairman.

Mr. OSE. I want to go back to a question I have. In terms of the long-term contracts themselves, have you had any direct communication with utility executives advising for or against using long-term contracts?

Ms. LYNCH. Well, the way the Commission works is, the utilities bring in an application and then there is a pending matter before us the parties can comment on. So I have certainly seen their materials as they have, you know, presented as a party to me, and considered those materials carefully when we gave them the authority that they requested.

Mr. OSE. My question was whether or not you have had any communications with utility executives advising for or against long-term contracts?

Ms. LYNCH. I do not understand advising for or against. Do you mean giving them my policy pronouncement?

Mr. OSE. Have you talked with utility executives, privately or publicly, in favor of or against the use of long-term contracts?

Ms. LYNCH. Well certainly publicly by my votes and statements regarding my support for long-term contracts. And privately, I do not recall.

Mr. OSE. Now, if I understand your support, the caveats are that they go through the PX, and that they be within the 5-percent margin that Mr. Makovich was talking about.

Ms. LYNCH. For preapproval. But they would always just be subject to the normal reasonableness review that all other States give to essentially any procurement actions of the utilities. So the retrospective reasonableness approval or review is a function of what a prudent utility would do at the time when faced with those facts at the time. So it is a question in time. It is not that you can apply tomorrow's standards to today's actions. You apply today's standards to today's actions, as all the other States do.

Mr. OSE. Are you familiar with Doug Long's letter to the two utilities objecting to their methodology for entering into long-term bilateral contracts?

Ms. LYNCH. I know there is lots of correspondence that goes between my staff and utilities on a variety of matters. I do not know which particular letter you are referring to.

Mr. OSE. Well, Doug Long is the gentleman on the California Energy Division who apparently has staff jurisdiction over the question of forward contracting. Am I correct on that?

Ms. LYNCH. He is one of the managers in the Energy Division.

Mr. OSE. OK. Now, it is my understanding, from feedback I have had directly, that he has opposed very, very strenuously on the methodology put forward by the utilities to try and hedge their exposures. Is that consistent with your understanding?

Ms. LYNCH. My understanding is the Commission made a decision which is then the policy of the regulator to allow the utilities to move forward consistent with reasonableness reviews that are in place in every other State.

Mr. OSE. OK. One of the questions I have as a business person is, I like to think of certainty when I am entering into an application in front of a government agency. We have heard back and forth, is this one reasonable, is that one not reasonable. The question I have is, was there ever a point at which the PUC undertook to define in a prospective basis what was reasonable and what was not reasonable?

Ms. LYNCH. Actually, yes. Based on—and I am not recalling specifically why I thought the utilities wanted further guidance, but it could well have been a conversation. I just do not recall.

Mr. OSE. Did that occur in August, September, March? I mean, how long are we talking about?

Ms. LYNCH. In the fall. Because by November, I decided to go ahead and provide additional guidance which I put for a vote of the Commission in December. So I put it on our agenda, essentially, for additional guidance at the time.

Mr. OSE. Are those reasonable standards now adopted by the PUC?

Ms. LYNCH. They are not, because at that point I believe I put it on for a vote right at—well, we put it on before we knew, I think, or right around the time that the FERC blew out the price caps. And so the anticipation was that it would be at least under the soft caps that the FERC had proposed. The actuality then, when prices shot up five times in 5 days in the California market, that volatile market then outstripped the parameters that I was proposing.

Mr. OSE. Let me go back to the standards; I think that was the basis of my question, not what FERC did or did not do. If I understand correctly, then, the PUC still has not issued a final determination for use by the investor-owned utilities as to what is or is not a reasonable standard for forward contracting?

Ms. LYNCH. The reason I mentioned FERC is because the market determines—we have to understand the market to be able to determine what is reasonable, and the market has been so out of whack in California——

Mr. OSE. OK, let us cut through all that. Has the PUC issued standards for reasonable or unreasonable forward contracts for use by the investor-owned utilities?

Ms. LYNCH. We issued our original standards in August. I provided some additional further guidance that I put on the agenda, and thereafter the utilities stopped buying on the spot. So it was essentially useless for the utilities, since they were not buying on the spot anymore.

Mr. OSE. Are those standards final?

Ms. LYNCH. No, they are not.

Mr. OSE. So, you have not completed the process?

Ms. LYNCH. Well, it is really the market outstripped our ability to determine what was reasonable in California.

Mr. OSE. Going back to my question, you do not have standards defining what is or is not reasonable in terms of forward contracts for the investor-owned utilities?

Ms. LYNCH. No, we do have initial standards that we adopted and put in place unanimously on August 3rd.

Mr. OSE. Are they final?

Ms. LYNCH. Yes, those are final.

Mr. OSE. They have binding protection, safe harbors for the investor-owned utilities?

Ms. LYNCH. There are some safe harbors, yes. But they wanted further guidance. And we have not refined with further guidance.

Mr. OSE. Do you have final standards defining what is or is not reasonable for long-term contracts for investor-owned utilities?

Ms. LYNCH. Yes. Our August 3rd standards are final. We could do additional refinements, which I proposed, which we have not finished. But we have guidance that we adopted on August 3rd. The utilities wanted additional guidance. We started designing additional guidance and then they dropped out of the market.

Mr. OSE. Just a moment.

Mr. HORN. Could we get when August is? Which year?

Mr. OSE. August 2000.

Mr. HORN. Excuse me.

Mr. OSE. August 2000.

Mr. HORN. OK.

Mr. OSE. Mr. Makovich, in terms of the buy-sell provisions of the PX, would you care to offer any insights as to the value of directing those contracts through the PX? Do you have any opinion on that?

Mr. MAKOVICH. Right. Well, in retrospect, the $50 per megawatt hour would have been a good deal for utilities to be able to lock into. People have then looked at that and said, well, the problem to this whole crisis is if the utilities had simply been allowed to lock into long-term contracts, we could have avoided this whole mess, and I think that is not right. That is wrong. And the reason for that is, if you allowed people to sign long-term contracts, let us say that voluntarily 80 percent of electric demand was covered under long-term contracts, the problem you have got then is those contracts are supplied from both existing plants—actually, the contracts that have been signed are mostly from existing plants. You are not building any new power plants. If you then end up with a shortage—and that is what we have got, we are fundamentally short of power plants—you cannot enforce on residential customers those that are covered by long-term contracts and those that are not.

So, unless the long-term contracts are mandated to cover 120 percent of the market to also provide you a reserve, they are not going to be the mechanism that builds enough capacity. If they did, if long-term contracts—assume that you got 120 percent voluntarily. The evidence is, if you do not have a shortage, the spot market clears on the basis of fuel and variable costs alone. Energy traders would then attack the long-term contract market. They would sell long, buy off the spot market, and arbitrage out any capacity payment that would be involved in those long-term contracts. And the only way to prevent them would be to have a shortage that disciplined that activity.

Mr. OSE. OK, you are going to have to speak in a language I understand and can communicate with.

Mr. MAKOVICH. OK.

Mr. OSE. Does that mean prices to consumers are higher or lower?

Mr. MAKOVICH. Prices to consumers would, I think, be terribly higher if you force long-term contracting. Remember, 50 percent of the stranded costs, when we started this whole process in California, were long-term energy contracts signed at what people thought would be reasonable rates out in the future, which were the PURPA contracts.

Mr. OSE. If the IOUs had the option of entering into long-term contracts to meet the load that they are historically familiar with——

Mr. MAKOVICH. Right.

Mr. OSE. [continuing]. Does the same conclusion hold?

Mr. MAKOVICH. No. The right type of long-term contract would be to require people that serve electric customers to sign capacity contracts. There is no reason to commit to the energy—to the utilization of the power plants. They need to pay people to have enough capacity to meet those future peak loads, and then simply have the option to run those power plants to produce the energy that they need.

Mr. OSE. So, a request from a power—or an IOU, such as PG&E or Southern California Edison or San Diego, have the hedging tool that a forward contract provides be available but not mandate——

Mr. MAKOVICH. Right.

Mr. OSE. [continuing]. You think it would lead to lower prices?

Mr. MAKOVICH. If you required people that produced—that served customers with electric energy, if they were required to also have enough capacity to meet their peaks, then you would create a market in which long-term contracting for capacity would be the mechanism by which that capacity payment is made. And then you are paying people to have enough capacity so you do not have a shortage.

Mr. OSE. Thank you. I understand that.

Mr. MAKOVICH. OK.

Mr. OSE. I have one final question, Ms. Lynch, the PUC recently recharacterized a certain amount of capital that PG&E or Southern California Edison or San Diego to change it from stranded investment to, if I understand correctly, advance payment for future power purchases. I am trying to figure out why that happened. I mean, explain that to me, if you would. What is transpiring there?

Ms. LYNCH. It is an accounting—it is a regulatory accounting treatment where, under the auspices of AB1890, two accounts were set up. One was for payment of their stranded assets, and one was for payment of their—I like to characterize it as operating costs versus capital costs.

Mr. OSE. OK.

Ms. LYNCH. Although I think that is oversimplifying it. The former PUC said you can essentially accelerate the depreciation of your capital assets in three ways. You can make a profit off the rates that are charged, and essentially match that up against an accelerated depreciation schedule. You can sell off your plants, and the profits used from that would also accelerate depreciation. And then you can also—there was the revenue from the ratepayer. There was the revenue that they made themselves from their retained generation, because they were selling that retained generation in the market. And then there was the plant sales. So three different revenue streams that could pay off their capital costs on an accelerated basis.

Mr. OSE. In fact, reduce to zero the basis that they had in those plants?

Ms. LYNCH. That was the goal of AB1890. And the bargain was that they got to accelerate the depreciation of their capital costs, which many people at the time thought were stranded assets, in order to assume the risk, on a going-forward basis, of their power purchases, of their operating costs.

So, rather than having the guarantee of the regulatory compact, that their costs would be covered, they took a bargain. They said we will get money up front for accelerated depreciation of capital if we take the back end risk of power purchase liabilities.

What the PUC did, in essence, was say, hey, wait a minute. Some of those revenues that you originally counted against accelerating your capital cost recovery were actually operating revenues. You got money from the ratepayers in their bills which—on an ongoing basis. You also got money from selling your own generation into the market. And that, in fact, your power purchase liabilities should be netted against your power purchase revenues before you get to transfer all those revenues over for accelerated depreciation of your capital costs.

So what the PUC said was, it is time to true-up the books. It is time to net out your operating costs and revenues before you just take the revenues and match them against your capital costs. Because, essentially, you are prepaying your mortgage before you pay your power bill or your light bill or your grocery bill. So we were saying you have got to pay your bills, your operating costs first, and then if you have money left over, you can prepay your mortgage. But you do not get to prepay your mortgage, and then come back to the ratepayers and say please help me with my monthly bills.

Mr. OSE. The PUC made this determination recently, if I recall.

Ms. LYNCH. On March 27th.

Mr. OSE. It would seem to me that the logic that you have just elucidated would also have held prior to the investor-owned utilities advising folks that they had recovered their entire stranded costs. I am trying to understand why this decision was not made last year at this time, instead of 6 months after the investor-owned utilities had advised everybody that they were ready to be free of 1890.

Ms. LYNCH. Well, the investor-owned utilities came into the Commission and applied for what they called a rate stabilization plan in October. And in that proceeding thereafter, some consumer groups came in and said hey, wait a minute. When we are looking at the true-up of all the accounting, you should make sure that operating costs are netted against operating liabilities before you apply them to capital costs. And so the PUC had a public proceeding where we took evidence from all sorts of parties and had lots of hearings from the period of October through March before we made the decision. So we did have evidentiary hearings and had full opportunity for public comment before we made the decision. But the decision—the question arose in October, and we fully vented it in public over the intervening months. But I will say this, we did take a little bit longer time in that decision because we put to the head of the pack the question of a rate increase. And so we originally granted a rate increase in January, and that did take precedence to this accounting true-up question.

Mr. OSE. Is this recharacterization the substance of the lawsuits in Federal court right now between the IOUs and the PUC?

Ms. LYNCH. Well, I have to say the utilities have thrown in the kitchen sink in claims, and so I am not exactly sure of their list of claims today. I would have to go back and check.

Mr. OSE. Well, I mean, is this one of them?

Ms. LYNCH. This well could be one of them. The essence of their claim is that they should be entitled to recover whatever they pay for power purchase costs, regardless of how much they got to prepay their mortgage in the past.

Mr. OSE. They are taking the position, under 1890, that they have recovered their stranded costs, and therefore should be relieved of the subsequent or the precedent requirements thereof?

Ms. LYNCH. They are taking the position that they do not have to true-up their operating costs before they transfer operating revenues over to the capital side.

Mr. OSE. You are arguing over definitions of what is an operating cost versus a capital cost, is that what you are saying?

Ms. LYNCH. It is an accounting treatment question. But I think that the utilities filed rate doctoring case actually involves much more than the accounting treatment. It involves the fundamental principle of whether a State, under State jurisdiction to control the retail rate paid by the ratepayer, has authority to shape the rate over time, and whether a State has the authority to pass a statute like AB1890 which gave a bargain and a risk to the utilities, or whether, instead, when the Federal Government allows market rates on the wholesale level to fluctuate, whether the State has to pass those volatile costs through in realtime without shaping the retail rate. So it is a larger policy question that is really at issue in the filed rate doctrine case.

Mr. BURTON. I have two quick questions. I hope they are quick. We heard from the other panel about the high cost of natural gas and how it has driven the costs of their businesses through the roof. In California, you have some substantial supplies of natural gas in the ground. What is the position of the administration, or do you know, on allowing the research and exploration for these reservoirs of natural gas to help create an increase in supply so that the cost can be going down?

Ms. LYNCH. I just speak for the Public Utilities Commission or for myself, as a commissioner. Certainly the Public Utilities Commission has done everything in its power to increase capacity for natural gas in California, and its storage. So, for instance, early last year——

Mr. BURTON. I am not talking about storage, I am talking about exploration.

Ms. LYNCH. The Public Utilities Commission does not do exploration.

Mr. BURTON. Well, I would like to maybe have somebody address that question to the administration, because you have reservoirs—according to some geologists that we know—in California of natural gas that could be tapped to increase the supply.

Let me ask one more question of Mr. Madden from FERC. How much could the California utilities have saved if they had not been prevented by the CPUC from entering into forward contracts? And can you give us an answer to that, for sake of the record?

Mr. MADDEN. I will provide my answer. I have already provided my answer to the committee, but I need to step-back so everyone will understand this. When we had the restructuring in California, the CPUC required the utilities, for the most part, to divest their thermal plants and CT plants; they kept their hydro, nuclear, except a couple of their plants. That was approximately 20,000 to 25,000 megawatts. Those plants were bought by numerous generators at premium prices, which helped the California utilities buy down their stranded costs.

As part of that structure, the utilities had to sell into and buy from the PX. And I do not know for a fact—I assume Ms. Lynch knows better—there is a per se prudence established in California that if you buy in the spot market, you are going to be per se prudent. And I also believe that there were some restrictions initially set by the CPUC on utilities as to the level or the amount of bilateral contracts they could have versus their overall portfolio. So, essentially, most of the market in California was in the spot market, because there was very little, if any, bilateral forward contracts. It has increased today. I think it might be 10, maybe 15 percent. That compares to a number of other States, I must say, that never required the divestiture of the utilities' facilities. And if they did, they allowed the utilities to buy back the power for a certain period of time. So with that perspective, let me try to answer your question.

Now, if we look at, for example, an entity wanting to purchase a forward contract last year, and the forward contract, let us say, was to start in May and they were looking for a price in April. There is some transparency out for California, and they can look at what the prices are, for the next month, for a 30-day service at Palo Verde or the California-Oregon border.

So when responding to the question of the committee, we looked at the amount it would charge for a megawatt hour of electricity last April for May delivery was $32 a megawatt hour. Then we looked at the recent filing that the Cal ISO submitted dealing with the $6.2 billion. They state for the May spot price in California, they averaged it at approximately $58 a megawatt hour.

So if you subtract the $32 that you could have paid from the $58 that the spot was going for, we arrived at a $26 megawatt-hour differential. Now, if you take the transmission load in California on a given day in May, you can approximate it is about 19 million, almost 20 million. If you look at the 20 million that is on the load times the differential of $26—the difference between the $32 and the $58—for May alone, if utilities bought on the spot for the delivery, they would have saved approximately $520 million for May.

Mr. OSE. If I understand, at the time in California, the power distributors were required to buy at the price set by the PX on any given day. So, it might well have been the $58 price. I mean, their buy-sell requirement forced them into the PX to buy, is that correct?

Ms. LYNCH. Well, what happened was, under the FERC rules, the highest priced bidder, that price was paid to everybody. And that was the PX price. Now FERC has changed that rule somewhat by saying essentially up to $150 everybody gets the same price, and then you file some paperwork and you get a higher price. But at that point——

Mr. OSE. FERC defined the rules for the PX?

Mr. MADDEN. Mr. Chairman, I believe Ms. Lynch is incorrect. We had a filing by the ISO, a tariff filing under section 205 of the act to implement the restructuring. The FERC reviewed that, received comments from the CPUC and from other parties, who I believe also supported it. They were required to pay the market clearing price established at the PX at that time. But this was not FERC alone. It was the submission by the ISO, and support and comments from other entities.

Now, Chairman Burton, I was also asked by committee to get an idea of, if we look at a big city in California, how much could we save? Well, Secretary Abraham testified last month at the Senate hearing. He noted that there was an offer by Duke to provide San Diego its entire load for a year at 55 megawatts an hour. I do not know the terms and conditions of that offer, other than the price. There may be some added provisions in it. But if you look at the load of San Diego, what its needs are, and you multiply that times the price that Duke was going to offer San Diego to meet its needs, San Diego, alone, would have saved $5 billion.

Mr. BURTON. $5 billion?

Mr. MADDEN. $5 billion. This is somewhat hindsight. I do want to make a comment that, contrary to some on the panel, I do believe in entities or IOUs having a mixed portfolio of contracts, spot, short, medium, and long. This does indicate that, based on hindsight, had they done this, this is how much the consumer would ultimately save.

Mr. BURTON. OK, let me ask a few more questions, then I will let my colleague from California, Mr. Horn, finish up.

This is on the issue that FERC, "Blew out the price caps." Mr. Winter, on December 7th you made an emergency request to FERC to relax the hard price cap, is that not correct?

Mr. WINTER. That is correct.

Mr. BURTON. Is it not correct, because not enough bids were coming in and the system was going to collapse?

Mr. WINTER. That is correct.

Mr. BURTON. Going into this summer we are being told that there is a shortage of 3,000 megawatts. Mr. Winter, what would happen, under these circumstances, if FERC imposed a hard price cap? Would the threat of blackouts get worse or better?

Mr. WINTER. I think it would probably get worse, because if the price cap was below what other States could provide at their cost, then we would end up being unable to get that power, and therefore would have to cut the load.

Mr. BURTON. OK. Mr. Makovich, would hard price caps produce more or fewer blackouts this summer?

Mr. MAKOVICH. Price caps, as currently set, either soft or hard, are making it worse, so they are going to extend the hours of outages.

Mr. BURTON. And Mr. Madden, do you want to answer that same question?

Mr. MADDEN. I cannot get into specifics because the issue is before the Commission in a number of hearings. But, my personal opinion is that hard caps do not provide the supply and the incentive for the need for power, for the need for generation.

Mr. BURTON. So your answer is pretty much the same as Mr. Makovich's?

Mr. MADDEN. That is my personal opinion.

Mr. BURTON. OK. Mrs. Lynch, what would a hard price cap do this summer with a 3,000 megawatt shortfall?

Ms. LYNCH. It is Ms. I am not married.

Mr. BURTON. OK. I am sorry.

Ms. LYNCH. That is OK.

Mr. BURTON. Forgive me.

Ms. LYNCH. I would join with economist Frank Wallach from Stanford and Chris Woodruff from southern California, and even Paul Krigman in the New York Times who say that price caps in a dysfunction market where there is no competition are needed as a market mitigation measure. The problem here is folks withhold. The sellers and the generators withhold. And if you do not discipline the sellers, then they have no incentive not to withhold, and then bid in right when the price gets to the very highest level. So even conservative economists like Paul Krigman of the New York Times saying in this market, with this level of dysfunction and market power evidenced, price caps are a necessity.

But I would go farther and say in fact what we need is cost-based pricing. We need cost-based pricing as a market mitigation measure, so that the sellers have to prove up their cost, and then gain a reasonable profit, rather than the many hundreds of times of profit that they are sucking out of the California economy.

Mr. BURTON. So you disagree with your colleagues at the table?

Ms. LYNCH. Certainly as to that effect, that is right. But I do agree with the vast majority of economists who have studied this market, in particular.

Mr. MADDEN. Chairman Burton, could I add?

Mr. BURTON. Yes.

Mr. MADDEN. As I note in my direct testimony, the Commission staff has prepared a market mitigation plan to go forward. And hopefully the Commission will bless that plan or approve some type of plan going forward in terms of addressing the current concerns of outages, the pricing at key times, the need for confidential information from the generators, and the questions of the requirement that generators be required to schedule and provide the service, if in fact they have the megawatts. We are receiving comments on that. So the concerns that are being raised as to manipulation, withholding, and market power are indeed going to be addressed in the very, very near future by the Commission.

Mr. BURTON. Give me a timeframe.

Mr. MADDEN. I would say we are on schedule. The Commission noted in its December order, by May 1.

Mr. BURTON. OK. Thank you, Mr. Chairman.

Mr. OSE. Mr. Horn.

Mr. HORN. Miss Lynch——

Mr. BURTON. Ms. Lynch.

Mr. HORN. Ms. Lynch, the latest—well, I called her president to start with. Is it a president or chairmanship?

Ms. LYNCH. It is a president.

Mr. HORN. President. We will go back to president then. When was the latest increase per kilowatt hour put at 3 percent? Did the Commission do that?

Ms. LYNCH. 3 cents a kilowatt hour.

Mr. HORN. 3 cents per kilowatt hour.

Ms. LYNCH. I wish it were 3 percent. We voted an additional 3 cents on March 27th. On January 4th, we voted a 1 cent increase, which was on average—a 1 cent increase is, on average, a 9-percent increase.

Mr. HORN. How did you come to that determination?

Ms. LYNCH. Through an evidentiary record where we hired independent auditors to look at the utilities and their affiliated companies' books and records, and then also allowed all parties an opportunity to present information about how much was needed in order to buy power in California.

Mr. HORN. Apparently it was issued, right?

Ms. LYNCH. Yes.

Mr. HORN. OK. Now, did it result in $45 million a day being spent on purchasing electricity? Did it help do that?

Ms. LYNCH. Well, whatever is spent is spent in the California market. The question is who is going to pay for that power purchase. And so what the Commission did was say the ratepayers of the investor-owned utilities in Southern California Edison and PG&E territory will bear the burden of paying the exorbitant wholesale prices to the extent of a total of a 4 cent increase on the kilowatt hour rate.

Mr. HORN. Do you think the explanation could also be that the rate increase would be allocated between the State and the small generators? Obviously the utilities would get some of it, but a lot of it would have been to get some money in the pot for everybody, I would think.

Ms. LYNCH. Absolutely, Mr. Horn.

Mr. HORN. Yes.

Ms. LYNCH. And, in fact, when we ordered the additional 3-cent rate increase, we also ordered the utilities to pay those small generators who were not being paid. I was quite disturbed, and my colleagues as well, that the utilities had stopped paying those small generators who are so key and critical to our reliability needs. So they are starting to pay. The order was, as of April 1st, you shall pay those small generators what is owed for the power produced by those generators.

Mr. HORN. Thank you, Mr. Chairman.

Mr. OSE. I want to followup on something. Mr. Madden, if I understood you correctly, you said that FERC's jurisdiction extends to roughly half of the market in California.

Mr. MADDEN. I do not believe I said half, but we do not have a substantial amount of jurisdiction over the energy that is sold into California because of municipals and co-operatives. It is about 50 percent, we do not have jurisdiction over 50 percent of the market West-wide.

Mr. OSE. OK. Energy Secretary Abraham advised me that it was 47 percent non-jurisdictional in terms of the California market specifically.

Mr. MADDEN. Chairman, I just do not have that figure. You have to look at how much energy is generated, and I just do not have it. It is a substantial amount. It is 40 percent, maybe. I do not have the exact figure.

Mr. OSE. Well, my real question is actually for Mr. Makovich, and that is that if FERC only regulates 40 to 50 percent of the wholesale power market in the West or in California, what is the consequence of putting caps on that portion of the market?

Mr. MAKOVICH. Right. The price caps are a very, very limited tool under the best of circumstances. If you can only impose it on half the market, you are likely to create far worse distortions than any kind of gain you are going to get from these price caps. As Terry mentioned, you are going to be giving people the incentive, for example, to move power to an area of higher return; to export it from California to Palo Verde to get a better return. And we saw that happen when we had these soft price caps in effect.

Mr. MADDEN. Mr. Chairman, as I mentioned, 50 percent of the energy produced in the West is non-jurisdictional to the Commission. And, of course, the issue has come up in a number of dockets, and I cannot talk about the merits, but I can tell you my views on that. It is very difficult to put a cap, as you mentioned, on only half the market, when the other half of the market is not capped. We saw that problem with gas 15 years ago when we regulated the intrastate side. Actually we did not regulate the intrastate side, but regulated the interstate side, and the interstate side of the market went to the intrastate side of the market.

Second of all, we have substantial amount of bilateral contracts in the West. Do you want to undo those contracts? If you had a cap and if those contracts exceeded the cap.

The third thing is you really do not have a spot market in the West as you do in California. So you do not have the control; you do not have the transparency you would need to do that. That said if a cap adds to or increases supply and decreases demand, maybe you should look at it. But it has to occur first.

Mr. OSE. Ms. Lynch.

Ms. LYNCH. California did have price caps up until November 1st, and the ISO voted an effective price cap of $250 a megawatt hour last July. So it is not as if we have not had experience with a market that actually worked somewhat under the prior caps. It is really the FERC's unprecedented action, beginning with their draft order in November and then continuing and extending more and more that has caused this issue and the bleeding of the California economy because of these outrageous wholesale prices. But it did work before. Perhaps imperfectly, but certainly much better than it works today with nothing, no protection for the California businesses or consumers.

Mr. BURTON. May I make one final comment?

Mr. OSE. You may, Mr. Chairman.

Mr. BURTON. I just want to make one final comment. I think we are about through with this panel.

Mr. OSE. We are.

Mr. BURTON. It is apparent, I think, to anybody who has taken a hard look at this, you need more generation in this State, you need more power plants and you need them online as quickly as possible. So, I hope that there is something worked out between the environmental organizations in this State and the utilities and the government so that they can get on with generating enough electricity to take care of the need. Because if you do not do that, this problem is going to get worse and worse and worse. I think that is what you mean, is it not, Mr. Makovich?

Mr. MAKOVICH. Yes.

Mr. BURTON. Yes. Thank you.

Mr. OSE. I want to thank the witnesses for coming. It has been a long panel, and I apologize. But you have so much information that we would like to glean from you, we could probably go another couple of hours. But we will not. So, anyway, thank you all for coming.

We are going to take a 5-minute recess, and then we will have the third panel join us.

[Recess.]

Mr. OSE. OK, we are going to reconvene. I want to welcome our third panel. That would be the Honorable J. William McDonald; Mr. Brian Jobson; Ms. Becky Dell Sheehan and Mr. Thomas Stokely. And, as with the first two panels, we are going to swear you in. So if you would rise, please.

[Witnesses sworn.]

Mr. OSE. Let the record show the witnesses answered in the affirmative.

As you have seen in previous panels, we have an opportunity for each of you to make an opening statement of no more than 5 minutes in length. So we will start with Mr. McDonald. You are recognized for 5 minutes.

STATEMENTS OF J. WILLIAM MCDONALD, ACTING COMMISSIONER, BUREAU OF RECLAMATION; BRIAN JOBSON, PRINCIPAL POWER CONTRACT SPECIALIST, SACRAMENTO MUNICIPAL UTILITY DISTRICT; BECKY DELL SHEEHAN, ASSOCIATE COUNSEL, CALIFORNIA FARM BUREAU FEDERATION; AND THOMAS STOKELY, SENIOR PLANNER, TRINITY COUNTY PLANNING DEPARTMENT

Mr. MCDONALD. Thank you, Mr. Chairman. I do have a written statement, and I will simply summarize it at this point.

Reclamation, as you may know, is the second largest hydropower utility in the United States. We have 194 generating units in 58 power plants throughout the 17 Western States with an installed capacity of just a little less than 15,000 megawatts. While our power plants are located throughout the 17 Western States, I will limit my remarks today to those parts of our system that are available to provide power to California.

Before I do that, though, let me review very quickly the six basic conditions under which our power plants are operated. The first, of course, is that in a hydropower system water is the fuel. While it has the distinct advantage of being an annually renewable fuel, it is also finite and highly variable from year to year. That is always the underlying condition in which a hydropower system operates.

Second, I would emphasize, in the context of our Federal power plants, that even if water is physically available in storage, the annual amount that is available to actually release through a power plant is governed by a complex set of laws in all instances. I would, generally speaking, break those into three. There are instances in which by virtue of international treaties, interstate compacts, and judicial decrees of the U.S. Supreme Court, the amount of water that is delivered on an interstate or international basis is governed by those institutional arrangements.

There often are Federal statutes which govern project operations and the parameters within which we operate. And finally, every project is, of course, individually authorized. Without exception, power is always a secondary purpose, not the primary purpose of any Reclamation project.

Third, it is in that context that, as we schedule releases of water, they are always governed by water user demands, since water supply is the primary purpose of our projects, both for irrigation, and municipal and industrial purposes.

Fourth, to the extent that we do generate power, it is always first used for project purposes; for example, the pumping of irrigation water supplies. It is only power that is surplus to project use that is available for marketing. With respect to that marketing, to take a very complex system and simplify it, I would make three main points.

First of all, the marketing is always done by the Western Area Power Administration or the Bonneville Power Administration, which are components, of course, of the Department of Energy. It is they who do the contracting and purchase all replacement power that is needed pursuant to those contracts. Second, they obviously enter into those contracts in accordance with Federal law. And finally, I would note that in general they contract to sell more capacity than is available on an assured basis year in and year out given the vagaries of a hydropower system. And it is expected, and it always has been, that they, too, will be in the marketplace buying power from time to time to cover the firm contractual commitments that they have entered into when we are in low water years.

Fifth, there are transmission constraints. I will not try to describe those at length here—there is a map associated with my written testimony—but will simply point out that even if Reclamation can generate energy, we cannot necessarily get it at all times to the right place given system constraints. We are not an owner or operator of any transmission, so that is beyond our control.

And finally, in this contemporary climate we operate with certain environmental considerations and respect for tribal trust assets. That most often comes in the form of downstream riverine environments and aquatic species that are of interest under a number of Federal laws. That largely translates into some limitations in certain instances on peaking power, that is to say, on instantaneous capacity, but not on total energy generated over time. That is because, except in a flood control circumstance, almost all water that we have available to us eventually runs through our power plants.

Let me turn now to the three major systems that are available to benefit California, touching very briefly on those. With respect to the Central Valley Project, we have about 2,000 megawatts of installed capacity. About 75 percent of the energy generated is surplus to project use. The other 25 percent is used for project pumping. All of that surplus energy is under contract by Western to users in California, principally in northern California.

For this summer, we face a forecasted runoff of only about 60 percent of average. We therefore think power generation will be only about 80 percent of average this summer. In that context, obviously, we will not be able to contribute, for lack of fuel, as much as we otherwise might. We are doing three main things, within that context, to try to help the California situation with the Central Valley Project. First of all, we have moved all maintenance forward so all units will be back online by the first of June. I might say, as a footnote, no planned outages this winter in any way impacted generation capacity because we lacked water to move through the remaining units that were up and running.

Second, we have been and will continue to shift project pumping to off-peak hours as much as possible, working in cooperation with the State water project, although there are some significant limitations on our ability to do that.

Finally, we will, of course, work with the California ISO and Western to optimize the scheduling of releases of our water for peak periods within the physical and operational constraints of our reservoir operations and our contractual deliveries to our irrigation and municipal and industrial contractors.

Let me turn next to the lower Colorado River dams, by which I mean Hoover, Parker, and Davis Dams and power plants, all of which are located on the Colorado River straddling the Nevada-Arizona California-Arizona borders. These plants have about 2,400 megawatts of installed capacity amd are operated within a very complex institutional system governed by the "Law of the Colorado River" that essentially dictates the annual release of water through the power plants on a monthly schedule.

Two things I would emphasize in that context. To the extent there is surplus power, 50 percent of it, by law, is sold to California. Southern California entities are the beneficiaries of Hoover, Parker, and Davis. All of that power is under contract pursuant to Federal statutes.

Finally, again with respect to maintenance, we have accelerated all maintenance, and will have all units that were otherwise regularly out for maintenance this winter back on line by the first of June.

The Federal Columbia River Power System is the third major system one that can provide power. When I talk about the Federal Columbia River Power System, I am talking about the 12 Corps of Engineer facilities and the two Reclamation power plants that operate as an integrated system for hydropower and flood control in the Columbia River Basin. Historically, California has peak demand in the summer, and the Pacific Northwest and British Columbia Hydro would sell power to California in the summer. Vice-versa, the Pacific Northwest peak load condition is in the winter. California would typically sell to the Pacific Northwest in the winter. That is not going to be possible this summer. Basically, we are at a near record drought of only 50 percent of average this year, and all power generated by the Federal Columbia River Power System is going to be required by the Bonneville Power Administration to meet its contractual commitments to its contractors, and even then, it is likely to face shortages and have to purchase additional power in the marketplace.

We are also quite concerned, in the face of the drought, about conserving fuel, or water, as best we can because our reservoirs are at historically low levels. As we go into the November-December timeframe, if a normal water year does not materialize, the Pacific Northwest will be in worse condition than we are presently.

Mr. Chairman, with that, I will conclude my oral comments and be glad to respond to questions.

Mr. OSE. Thank you, Mr. McDonald.

Our next witness is Mr. Brian Jobson, who is the principal power contract specialist for the Sacramento Municipal Utility District. Mr. Jobson, 5 minutes.

[The prepared statement of Mr. McDonald follows:]

Statement of Bill McDonald
Acting Commissioner, Bureau of Reclamation
Department of the Interior
before the
Subcommittee on Energy Policy, Natural Resources & Regulatory Affairs
Committee on Government Reform
U.S. House of Representatives

April 10, 2001

I am Bill McDonald, Regional Director for Bureau of Reclamation's (Reclamation) Pacific Northwest Region located in Boise, Idaho and am currently serving as Acting Commissioner. I appreciate the opportunity to discuss Reclamation's role in regulating the flow of water on key rivers and the impact on output of hydroelectric plants that are operated by Reclamation.

Before I discuss Reclamation's current activities as they relate to the generation of hydroelectric power, I would like to give the Subcommittee some background on Reclamation's hydroelectric power activities. This should provide important context as we discuss the current situation and Reclamation's role and activities.

Background

The Bureau of Reclamation is the nation's second largest producer of hydroelectric power. It ranks as the 11th largest generator of electric power in the United States with 58 hydroelectric powerplants, 194 generating units in operation and an installed capacity of 14,744 megawatts (MW). In addition, Reclamation has a 547 MW share of the installed capacity of the coal-fired Navajo Steam Powerplant. The power produced at such projects that is available for commercial sale is marketed by the Western Area Power Administration (Western) and the Bonneville Power Administration.

Reclamation powerplants annually generate about 49 billion kilowatt hours (kWh) of hydroelectric energy—enough to meet the annual residential needs of over 14 million people or the electrical energy equivalent of over 80 million barrels of crude oil. Currently Reclamation's

Central Valley Project accounts for about 5 percent of California's installed capacity in state. Westwide, Reclamation helps to maintain the stability and reliability of the overall power grid through the Western Systems Coordinating Council (WSCC) - a voluntary system reliability organization in which Reclamation, the California utilities and 13 other western states participate.

Over the past 25 years, Reclamation has done a great deal to increase the generation capacity of its hydroelectric facilities throughout the west. In 1976, Reclamation had 50 powerplants with a total capacity of 9,111 MW. Today, Reclamation's 58 powerplants have an installed capacity of 14,744 MW for a 62 percent increase. It is important to note that Reclamation's aggressive uprating and rewind program at existing power plants accounts for more than 1,783 MW of that increase, which represents 12 percent of Reclamation's total generation capacity.

Legal and Operational Issues: While Reclamation's installed nameplate capacity is significant, there are a number of legal and operational factors that limit energy generation.

1) Power is Secondary Purpose: Reclamation's hydroelectric power facilities are part of specifically authorized multipurpose water projects which provide benefits such as irrigation, municipal and industrial water supply, flood control, fish and wildlife protection and recreation. Power is, by statute for most projects, a secondary project function to delivery of irrigation and municipal and industrial water supplies. This means that water deliveries, pursuant to contracts, take precedence over electric power generation. Furthermore, many projects are required to schedule water deliveries in accordance with interstate apportionment decrees and compacts and with international treaties. Therefore, water may not be available to generate power, as it may be committed to a primary project function such as flood control, or agricultural or municipal and industrial deliveries. In some cases, Reclamation may be required to release more water from its reservoirs than can be accommodated using only the power plant turbines.

2) Only *Surplus* Power is Marketed: Under Reclamation law, the first priority for the use of

power generated by Reclamation's projects is to meet the needs of that project. This includes power for pumping water for delivery to our water users. On a Reclamation-wide basis, about 5 to 7 percent of the power we generate each year is used for project purposes. Within parts of the Central Valley Project (CVP) in California, however, there are times of the year – particularly during the irrigation season – when our generation does not even produce enough power to meet the project's pumping needs. In response, Western must buy power to serve irrigation needs on the spot market just like any other power user.

When there is power surplus to a project's needs, it is provided to Western or the Bonneville Power Administration (Bonneville) in the Pacific Northwest. Reclamation manages only the generation of power at its facilities. These Federal agencies in turn market this power to customers who are primarily preference customers, such as municipal utilities, as required by statute. Portions of the revenues derived from such sales are used to repay their investment costs that are the responsibility of the irrigators but exceed their ability to repay.

3) Power is Already Committed by Contract: As the marketers for Reclamation's power, Bonneville and Western have entered into contracts with preference customers for all of the anticipated available generation. The only time that additional power may be available to non-contracted entities is when there is excess water in the system that can produce more power than is already obligated or expected. All power generated at Hoover Dam is committed even when there is excess water in the system. In a dry year, however, Western and Bonneville have to buy power from other sources to make up the difference in their existing contracts. In a normal or dry year, there is little or no power produced that is not already under contract through Western or Bonneville.

4) Transmission System Constraints: Map #1 attached to my testimony, shows a multitude of power facilities - albeit small ones - on the east side of the Continental divide. These facilities currently serve customers in the regions in which they are located. Map #2 shows that the Federal transmission system is not designed to move power from these units long distance to

California. Also, within California, the capacity to move electricity, particularly from the south to the north, is limited. Thus, although Reclamation through Western, delivers power from Hoover, Parker and Davis Dams on the Lower Colorado River to Los Angeles and Southern California, there is at times insufficient transmission capacity to get that power to northern California - where much of the recent need has been.

There is also no Federal transmission line to get electricity from Glen Canyon Dam, on the Colorado River, to either southern or northern California. Power from Glen Canyon Dam can be sent to Arizona, but there is usually insufficient transmission capacity to get electricity through Arizona to California. To do so would displace other power that is also intended for California, unless Western is able to exchange power with some other entity.

5) Hydrologic Conditions: Water is the fuel for a hydropower system. While water is an annually renewable fuel, its availability varies considerably from year to year.

In California, water supply forecast is now about 40 percent below normal. As a result, Reclamation's hydro generation is below average. Reclamation's CVP power facilities, in an average summer, generates 5,000 gigawatt hours(GWh). This summer, however, due to low river and reservoir levels, CVP facilities are expected to generated only about 4,100 GWh -- which is 18% below average.

In the Pacific Northwest, the runoff forecast is for a near record drought. While the average annual flow of the Columbia River at the Dalles is about 106 million acre feet, flows this year will be only half that amount.

6) California/Northwest Exchange: Historically, the Pacific Northwest and California have exchanged power during their respective high demand seasons – winter in the Pacific Northwest and summer in California. In the summer, when the Northwest's demand is lower, the Pacific Northwest exports power to California – during its high demand season. Then, in winter, when

California's demand is – on average -- lower, California exports power to the northwest - where the winter months are colder and demand is higher. This relationship has served both regions well.

Unfortunately, it is not working that way this year. As we saw this past winter, California was only able to export power to the north, as they were not able to meet their own winter needs. In fact, California found itself in need of imported power (at a time when they usually export it). This meant that Bonneville, which usually depends upon California's imports, did not have imported power available to meet its customers' load. In response, Bonneville needed to increase the output of the facilities of the Federal Columbia River Power System (FCRPS), as well as buy power on the spot market. It also meant that there was significant draw down of the reservoirs in the FCRPS. This year, with the dry weather, there is little prospect that these reservoirs will be able to refill this summer. To California, this means that the Pacific Northwest may not be able to export power during the upcoming summer months. Bonneville will continue to exchange energy whenever possible to help California with peaking problems while providing the Northwest with much needed energy.

7) Environmental Considerations: Reclamation must also operate its projects consistent with environmental laws, such as the Endangered Species Act. In any hydropower system there can be significant fluctuations in flow that may have impacts on the environment and recreation. Since most Reclamation hydropower facilities are located on rivers inhabited by threatened and endangered fish species, operations are constrained to ensure that these fish and their habitat are not jeopardized by adverse flow schedules or pulsed flows. We are coordinating with National Marine Fisheries Service and the U.S. Fish and Wildlife Service to identify opportunities to provide additional assistance for power generation that will not adversely affect these fishery resources.

System Reliability: Mr. Chairman, one of the significant benefits of hydropower, in general, and Reclamation's system, in particular, is the flexibility it affords. Hydro generation can be ramped up or down very quickly to respond to changes in demand and to the needs of the regional transmission system to remain stable. (A caveat here is that rapid changes may have detrimental fish and wildlife impacts.) Because of the size of Reclamation's system, along with its capacity and the large number and diversity of units available, Reclamation serves as a mainstay for ensuring the reliability of the Western Interconnected System. In the event of a WSCC system emergency, Reclamation hydro power can be brought on-line quickly to meet system emergency demands. Reclamation hydro power also provides voltage control, load following, spinning reserves, and black start capability– all of which provide stability to the western power grid.

Current Activities in Response to Power Crisis: Reclamation works closely with Bonneville, Western, the WSCC and the California Independent System Operator (ISO) to provide whatever assistance it can to California.

1) Adjustments to Increase "Peaking Power": Reclamation continues to work on flexible power generation schedules to support the needs of the western power grid. Western, on behalf of the California ISO, routinely asks Reclamation to rearrange its power generation schedule to help with the morning and afternoon peaks. In many cases, Reclamation has asked its project pumping customers to shift the timing of their deliveries to off-peak times to make more peaking power available to the market. At Grand Coulee Dam in eastern Washington, we have been able to shift more than 300 megawatts of pumping load to off peak times – making it available to Bonneville for peaking purposes. This summer in the CVP, Reclamation anticipates that significant project pumping loads can be shifted to off-peaking, making that power available to Western to help meet the demand for peaking power in California.

2) Conservation: Reclamation continues to maximize power production and minimize consumption to reduce projects needs and make power available. We have also facilitated the purchase of water that would otherwise need to be pumped or diverted upstream of the generators. This makes both more water available for generation and makes some "project use power" available to the market.

3) Maintenance Schedules: Over the past year, Reclamation has worked very closely with Bonneville and Western to coordinate scheduled maintenance activities to maximize the number of facilities on line to respond to the energy needs of the western United States. In many instances scheduled maintenance that requires outages, has been delayed or rescheduled to accommodate system needs. Where maintenance cannot be delayed, Reclamation has resorted to double shifting at some facilities, and a greater use of overtime, to shorten the time that facilities will be out of service.

4) Responses to Stage 3 Emergencies: While Reclamation's ability to generate power sometimes is limited by the factors identified above, we have been able to respond to requests from Western and Bonneville on behalf of the California ISO during many of the recent emergencies to provide additional power to California. Within the CVP, for example, Reclamation placed all its CVP generating units into production for the duration of the emergency. In the Pacific Northwest, Reclamation, in consultation with Bonneville, reshaped the water releases to assist California during Stage 3 events. In addition, the following chart indicates the specific increases from Hoover and Glen Canyon dams as of March 20, 2001.

Facility	**Date**	**Emergency Stage**	**Length of Time**	**Generation Increase**
Hoover Dam	12/7/2000	Stage 3	2 hours	800 to 1,500 MW
Hoover Dam	1/11/2001	Stage 3	15 hours	300 to 1,200 MW
Hoover Dam	1/12/2001	Stage 3	3 hours	300 to 500 MW
Hoover Dam	1/16 - 2/16	Stage 3		Initiated double Peaking schedule
Glen Canyon Dam	9/18/2000	Stage 3	4 hours	523 to 655 MW
Glen Canyon	2/15/2001	Stage 3	5 hours	496 to 784 MW
Glen Canyon	3/19/2001	Stage 3	10 hours	420 to 791 MW
Glen Canyon	3/20/2001	Stage 3	5 hours	575 to 826 MW

Future Activities and Opportunities: As stated above, Reclamation has over the past 25 years undertaken an aggressive uprating and efficiency improvement program, which has significantly expanded the capacity of our hydropower system. While most of the significant benefits have already been realized, Reclamation has identified and will continue to explore additional opportunities to further expand our capacity and efficiency.

1) Increase Efficiency and Reliability: In partnership with Bonneville, Western and some of our power customers, Reclamation is working to replace the turbine runner blades in some of our facilities. The on-going runner replacement work at Grand Coulee, for example, can increase the efficiency of the facility and will result in 45-50 MW of additional energy at the facility. Reclamation is exploring the feasibility of other investments such as a similar effort at Shasta Dam in California which could result in an additional 51 MW of power. We estimate that by doing this at other Reclamation facilities, Reclamation could realize an additional gain of as much as 350 MW over the next 5 to 10 years.

2) Additional Uprates and Rewinds: While most of the significant increases in capacity have already been realized by our long standing uprating and rewind efforts, we can see that over the next 5 to 10 years, an additional 200 MW gain is possible across all of Reclamation's power system.

3) Increased Focus on Power Facility Reliability - Reclamation hydropower plants are an average of 44 years old. Given this aging infrastructure, Reclamation is placing an increasing emphasis

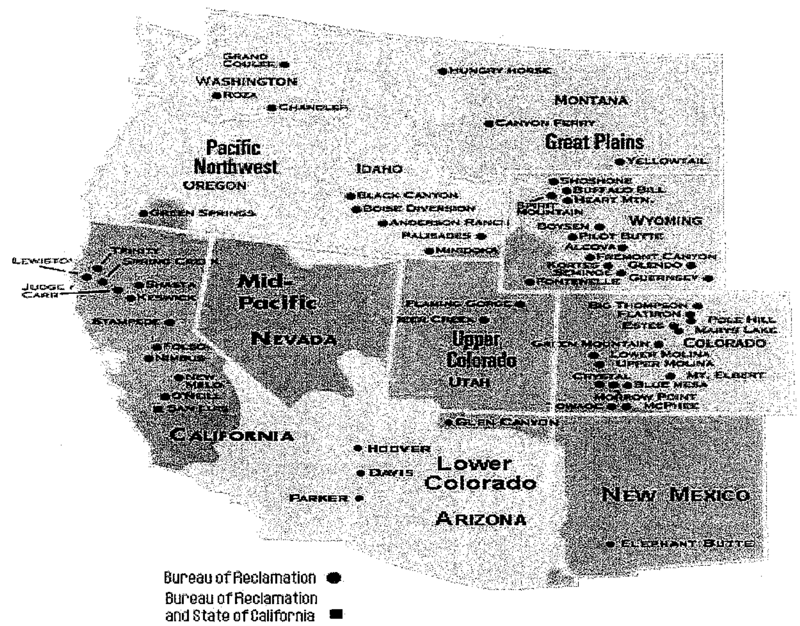
on the reliability of our plants in our operation and maintenance activities. Additionally, we are exploring the possibility of Reliability Centered Maintenance and Life Extensions in order to assure continued reliability of our plants.

Conclusion

In summary, Mr. Chairman, Reclamation's hydropower projects play a significant role in addressing California's power needs - both in terms of supply and in terms of maintaining the stability of the system. In the summer of 2000, and so far in 2001, the below normal water supplies have limited and will continue to limit our ability to generate hydropower.

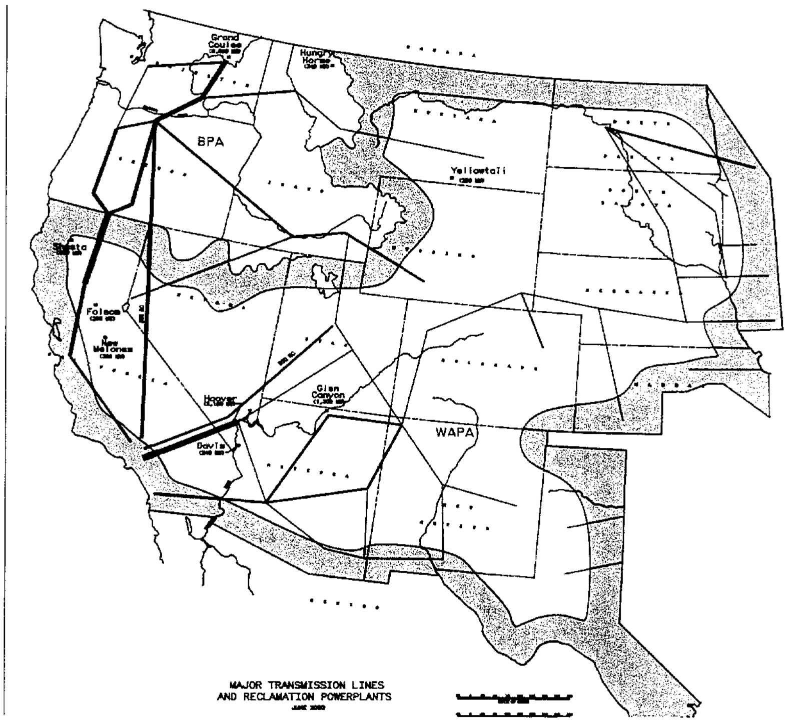
This concludes my testimony. I would be glad to answer any questions.

Map 1
Location of Reclamation Power Facilities



Reclamation's Power Facilities

Map 2
Transmission System Constraints



Mr. JOBSON. Good afternoon Chairman Ose and Chairman Burton and Congressman Horn. I am here representing the Sacramento Municipal Utility District to testify on the power supply reductions that could result from restoring fisheries on the Trinity River in the way prescribed by the record of decision that mandates increased flows to the Trinity River. But before I get into that, I want to make a note about the Federal agencies involved in SMUD's power supply from the Federal Government.

As they are under your purview, I think it is important that you know that the cooperation that we have received in making as much power available from the CVP has been phenomenal. And this is by both the Bureau of Reclamation and the Western Area Power Administration. We have advanced customer funds, tens of millions of dollars, to rewind units, repair tunnels, avoid bypasses of power plants, add transformers at transmission stations and replace any other facilities that are in need of it, and as was mentioned by Mr. McDonald, accelerated on maintenance necessary to make sure all facilities are in service. At all levels in these organizations the cooperation has been terrific.

Getting on to the Trinity River issues. On October 19th, 1999, the Department of Interior's Fish and Wildlife Service and Bureau of Reclamation released for comment the Trinity River Environmental Impact Statement report. The report's preferred method for restoring fishery habitat of the Trinity River relies on dramatically increased water releases from Trinity Dam to create a more natural flow regime. The Fish and Wildlife's preferred flow schedule will result in reduced availability of power generation from the Central Valley Project, degrading the reliability of California's electric system, and driving up the price of power to consumers. This comes at a time when California is suffering an electricity crisis, as you have heard, with rolling blackouts and dramatic price spikes that threaten the economy of California, the West, and the Nation as a whole.

Specifically, the proposal would result in approximately 250,000 megawatt hours of hydroelectric energy forgone in an average year if interior's alternatives are implemented. This is enough energy to meet all the needs of 31,000 households for a year, or to meet all the needs of the State of California on a summer afternoon for about 6 hours. The capacity lost in a critically dry year, which is when hydroelectric capacity should be measured, would be about 150 megawatts. And when combined with the power impacts of implementing the Central Valley Project Improvement Act, which has been largely implemented, the total reduction would be approximately 325 megawatts, as has been documented by the Western Area Power Administration.

Interior's proposed flow decision would also reduce water supply to CVP supplied farms and cities, and raise temperatures in the Upper Sacramento River, increasing mortality to juvenile salmonids that are supposed to be protected by the Endangered Species Act.

SMUD contends that many of these adverse impacts are largely avoidable if the Trinity River restoration proposal is amended to include non-flow habitat maintenance measures to conserve water, essentially getting good results by using less water. For instance, SMUD has suggested in its comments on the EIS/EIR various alternative ways of restoring the fishery. Modifying interior's proposal, for instance, by controlling revegetation of gravel bars used for spawning by manual measures, hand crews or light equipment, rather than keeping them flooded for weeks at a time to prevent the seeds from germinating.

Another example, we have suggested constructing silt traps on tributary streams to reduce siltation in the river, as has been done at Grass Valley Creek, rather than relying on very high flows to entrain the silt to be deposited downstream in the Trinity River flood plain or the Klamath River further downstream.

Most remaining features of the Interior restoration plan are retained in our power alternative, including pulse flows, but at a reduced magnitude and duration. And while the power alternative will result in some loss of hydroelectric generation and water supply, the loss would be roughly 70 percent reduced from Interior's alternative. In addition, adverse impacts on Sacramento River and Delta endangered species would be less under the power alternative. These ideas were rejected by Interior under the prior administration. At a time when the State of California is desperately in need of more power production, it seems incomprehensible to SMUD that the Federal Government would act in a counterproductive manner by taking power resources off line when better and less drastic alternatives exist.

In the interest of time, I do not want to dwell on each and every concern SMUD and other power users like NCPA have with the EIS/EIR, or spell out in detail the scientific flaws and procedural infirmities with which the Endangered Species Act compliance and the National Environmental Policy Act compliance were completed. These are identified in documents that are of record already, and these are issues that are being litigated presently.

The good news is that it appears that the Department of Interior in this new administration will have the opportunity to revisit this decision. And I will point out that there are more agencies involved within Interior than the Bureau of Reclamation, who is the only one represented here.

In light of SMUD's history as an environmentally conscious utility, and its own belief the Trinity River fishery should be restored, SMUD and other CVP power customers, like the Northern California Power Agency, sincerely hope that interior will reconsider the power alternative during its preparation of the supplemental environmental impact statement report that it appears the Federal court will require.

SMUD is willing to work with interior to modify the power alternative to address legitimate concerns that may be raised. We hope that interior will engage in a meaningful dialog with SMUD and other power and water customers to develop a final restoration plan that minimizes impacts on water and power supply, and on the Sacramento River fisheries while restoring Trinity River fishery habitat. Any assistance the committee can provide will be greatly appreciated.

Mr. OSE. Thank you, Mr. Jobson. We will be back to you with questions after we get through the other statements.

I would also like to welcome today Ms. Becky Dell Sheehan, who is the principal power contract specialist for the California Farm Bureau. Welcome, Ms. Sheehan, for 5 minutes.

[The prepared statement of Mr. Jobson follows:]

House Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs

Oversight Hearing on the California Energy Crisis

Sacramento, California

April 10, 2001

Testimony by:

Brian Jobson, Supervisor of Regulatory and Contracts

Sacramento Municipal Utility District

Chairman Ose and other members of the Subcommittee, I am Brian Jobson, Supervisor of the Regulatory and Contracts Division of the Sacramento Municipal Utility District (SMUD).

I commend your Subcommittee and the Committee on Government Reform for holding this series of hearings in California and hope that the proceedings over the course of the next few days help resolve the ongoing energy crisis in our state - as well as in those states surrounding California. I want to particularly commend Congressman Ose for his continued attention to these matters and for his work on helping to resolve contentious issues affecting SMUD's ratepayers.

On behalf of SMUD, I am here to testify on restoring the fisheries on the Trinity River, including the adverse impacts of the Record of Decision mandating increased water releases downstream. Since SMUD receives 20% of its power needs from hydropower generated from Central Valley Project (CVP) facilities, any change in the Trinity River Division's power generation ultimately impacts the reliability and cost of power supply to SMUD's 1.2 million customer owners.

At SMUD, I am responsible for the regulatory and contractual issues regarding SMUD's resources including Central Valley Project power contract supply issues.

On October 19, 1999, the Department of Interior's Fish and Wildlife Service and Bureau of Reclamation released for public comment the Trinity Environmental Impact Statement/Environmental Impact Report, which I will refer to as the EIS/R. The EIS/R's preferred method to help restore fishery habitat relies on dramatically increased water releases from the Trinity Dam to create a more natural flow regime. The Fish and Wildlife's preferred flow schedule will result in reduced availability of power generated from the CVP, degrading the reliability of California's electric system and driving up the price of power to consumers. This comes at a time when California is suffering an electricity crisis, with rolling blackouts and dramatic price increases that both threaten the economy of California, the West, and the nation as a whole.

Specifically, about 250,000 MWh of electric energy will be lost in an average year if Interior's alternative is implemented, which is enough energy to meet the needs to 31,000 households all year, or enough to supply all the energy for the ISO control area on an average summer afternoon for six hours. The capacity lost in a critically dry year would be about 150 MW, and, when combined with the power impacts of implementing the CVP Improvement Act, would reduce the CVP hydro capacity by 325 MW in a critically dry year. Interior's proposed Trinity Flow decision would also reduce water supply to CVP supplied farms and cities, and raise temperatures in the upper Sacramento River, thus increasing mortality to juvenile salmonids that are supposed to be protected by the Endangered Species Act.

SMUD contends that these adverse impacts are largely avoidable if the Trinity River restoration proposal is amended to include non-flow habitat maintenance measures to conserve water, essentially getting good results by using less water.

SMUD proposed that approach in an alternative restoration plan contained in SMUD's comments on the EIS/R. Specifically, SMUD's alternative suggests controlling revegetation of restored gravel bars by hand crews or light equipment during low flow periods, rather than inundating the bars for long periods of time. SMUD's power alternative also suggests constructing additional silt traps on tributary streams, as has been done on Grass Valley Creek, rather than relying exclusively on very high flows to entrain the silt later in the Trinity floodplain or the Klamath River downstream. Most remaining features of the Interior restoration plan are retained in the power alternative, including pulse flows but at a reduced the magnitude and duration. And while the power alternative will result in some loss of hydroelectric generation and water supply, those losses will be roughly 70% less than Interior's preferred alternative. In addition, adverse impacts of the preferred alternative on listed fish species in the Sacramento River and Delta will be significantly reduced by implementing the power alternative.

At a time when the state of California desperately needs more power production, it seems incomprehensible to SMUD that the federal government would act in a counterproductive manner by taking power resources off-line when better and less drastic alternatives exist.

In the interest of time, I do not want to dwell on each and every concern SMUD has with the EIS/R. For further analysis, committee members and staff can refer to SMUD's comments officially submitted comments to Interior, which I respectfully request to be entered into the hearing record.

In light of SMUD's history as an environmentally conscious utility and by its own belief that the Trinity fisheries should be restored, SMUD and other Central Valley Project power customers sincerely hope that Interior will reconsider the Power Alternative during its preparation of the supplemental EIS/R that the federal court recently ordered it to prepare. SMUD is willing to work with Interior to modify the power alternative to address legitimate temperature concerns and reach a compromise solution. We also hope that Interior will engage in a meaningful dialogue with SMUD and other power and water customers to develop a final restoration plan that minimizes impacts on water and power supply, and on Sacramento river fisheries, while restoring the Trinity River fishery.

Ms. SHEEHAN. Thank you, Mr. Chairman. Actually, if I could clarify the record, my title is mistaken. I am an associate counsel, and I work primarily with water and land use issues.

Mr. OSE. We are interested in accuracy and we will make that correction.

Ms. SHEEHAN. Thank you. Thank you, Mr. Chairman.

My name is Becky Sheehan, and I am Associate Counsel for the California Farm Bureau Federation. The California Farm Bureau Federation represents approximately 40,000 farm and ranch families, constituting approximately 80 percent of California's production agriculture. Farm bureau members have been paying more than $650 million annually for their electric service, and with the recent rate increases, they will be paying more than $900 million. When this year is compared to last, our members' energy costs will have risen approximately $250 million.

The State of California cannot afford any further reductions in energy and water supplies this year or in the near future. The Trinity River Fishery Restoration decision will have impacts that were not adequately considered in the decision's joint environmental documents. The current Trinity decision will exacerbate a crisis that has already begun to jeopardize the future of agriculture in California. California's farms provide a resource of State, national, and worldwide importance. As such, the lead agencies should supplement the existing environmental document and consider the Trinity decision's impacts in light of the current energy crisis.

The current energy crisis and the ongoing water crisis are intrinsically linked, with a shortage of one increasing the cost and the availability of the other. This year in California we will have probably a dry or critically dry water year which will limit our ability to produce hydropower, which is the flexible and reasonably priced energy source California relies upon to cover our peak energy periods. At the same time, our usual dry year alternative, groundwater, that will be necessary to use to sustain California during a long, hot, and dry summer will be very difficult to draw upon because the high energy cost may make pumping groundwater cost prohibitive.

Farmers and ranchers cannot pass the higher cost of doing business on to the consumer. While agriculture is an important business in California, the farms and ranches are predominantly family operations with very small profit margins. Our farmers and ranchers cannot slash their overhead and ride out tough financial times because there is no large overhead to cut. As such, if all market indicators are proven correct, we will lose substantial agricultural resources this year because of the combination of the energy crisis, the dry water year, and the regulatory drought.

The Trinity decision is another example of an ill-considered government policy that will sacrifice our valuable agricultural resources without truly considering and mitigating these impacts as required by State and Federal law. The final environmental document does recognize that the Trinity decision will cause significant groundwater impacts due to overdraft, that agricultural production will be lost, and that agricultural lands will be fallowed. However, the magnitude of these impacts is not properly recognized. The agency's recommended mitigation for these impacts is the full implementation of the CALFED Program and the Central Valley Project Improvement Act. This is entirely inadequate, as these programs will have additional negative impacts to our agricultural resource base. While Farm Bureau is not opposed to the CALFED Program—in fact, we have been actively involved since its inception and continue to be so involved—we do have substantial concerns about the current programs significant and unmitigated impacts upon California's agricultural land and water resources.

Finally, the Farm Bureau has grave concerns about the underlying science and policy decisions that were made relating to fish biology; in particular, the Trinity decision's temperature impacts on threatened and endangered fish in the Sacramento River. Several listed species within the Sacramento River are being sacrificed in order to improve fish populations within the Trinity River. We are concerned that the regulatory agencies have not sufficiently considered these impacts or developed policies to maintain the appropriate temperatures in the Sacramento River during the implementation of the Trinity decision. Thank you.

Mr. OSE. Thank you, Ms. Sheehan.

Finally, on our third panel, I would like to welcome Mr. Thomas Stokely who is the senior planner for the Trinity County Planning Department. Thank you for joining us. You are recognized for 5 minutes.

[The prepared statement of Ms. Sheehan follows:]

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House of Representatives,
The Committee on Government Reform
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs
Sacramento, California
April 10, 2001

Thank you Mr. Chairmen for the opportunity to present testimony to the committee today. My name is Becky Sheehan, Associate Counsel with the California Farm Bureau Federation.

The California Farm Bureau Federation ("Farm Bureau") represents approximately 40,000 farm families. We are a voluntary, private, non-profit corporation representing more than 80% of California's commercial agriculture. Farm Bureau members have been paying more than $650 Million annually for their electric service; and with the recent rate increases they will be paying more than $900 Million annually. When this year is compared to last, our member's energy costs will have risen approximately $250 Million.

The State of California cannot afford any further reductions in energy and water supplies this year, or in the near future. The Trinity River Mainstem Fishery Restoration decision ("Trinity Decision") will have impacts that were not adequately considered in the decision's joint Environmental Impact Statement/Environmental Impact Report. The current Trinity Decision will exacerbate a crisis that has already begun to jeopardize the future of agriculture in California. California's farmers provide a resource of state, national, and worldwide importance. As such, the Lead Agencies should supplement the existing environmental document and consider the Trinity Decision's impacts in light of the current energy crisis.

The current energy crisis and the ongoing water crisis are intrinsically linked, with a shortage of one increasing the cost and availability of the other. It appears very likely that there will be blackouts this summer. California will not be able to rely on the Northwest for energy as the drought in Oregon and Washington will preclude them from generating the necessary hydropower to sufficiently supplement California's supply. This year in California we will have a dry or critically dry water year;

which will limit our own ability to produce hydropower, the flexible and reasonably priced energy source California relies upon to cover our peak energy periods. At the same time, the usual dry year alternative water source, groundwater, that will be necessary to sustain California during a long, hot and dry summer, will be very difficult to draw upon because our high electricity costs may make pumping groundwater cost prohibitive.

Farmers and ranchers cannot pass on the higher costs of doing business to the consumer. While the processor and the retailer can pass on higher energy and water costs by increasing the price of their product, agricultural producers are "price takers," thus, all increases in production costs are subtracted from on-farm income. While agriculture is a big business in California, the farms and ranches are predominantly family operations with small profit margins. Our farmers and ranchers cannot slash their overhead to ride out tough financial times because there is no large overhead to cut. In light of the tough financial times that have already affected most California farmers, due to the high cost of government regulation and lack of access to world markets, any negotiable overhead costs have in fact already been cut. The majority of our agricultural businesses cannot stop investing in California and take their businesses to other states, because the proper soil and weather conditions for their commodities are in California. As such, if all of the market indicators are proven correct, we will lose substantial agricultural resources this year because of the combination of an energy crisis, the dry water year, and the regulatory drought.

The Trinity Decision is yet another example of ill conceived government policy that will sacrifice our valuable agricultural resources without truly considering and mitigating these impacts as required by state and federal environmental law. The final environmental document does recognize that the Trinity Decision will cause significant groundwater impacts, due to overdraft, that agricultural production will be lost, and agricultural lands will be fallowed. However, the magnitude of these impacts is not properly recognized and the agency's recommended mitigation, i.e., the full and successful implementation of the CALFED Bay-Delta Program ("CALFED Program") and the Central Valley Improvement Act (CVPIA), is entirely inadequate. In fact, this action will cause additional significant and cumulatively considerable negative impacts. While the Farm Bureau is not opposed to the CALFED Program, and in fact have been actively involved in the process since its inception, we do have substantial concerns about the current program's significant and unmitigated impacts upon California's agricultural land and water resources.

In fact, last year's House Appropriations Committee on Energy and Water Development Subcommittee recognized that the Trinity Decision was likely to have water supply impacts in the Bay-Delta system and directed the Secretary of the Interior to account for the Trinity Decision's impacts upon the Central Valley within the CALFED process. In the Energy and Water Development Appropriations Bill of 2000, the House Committee Report 253 states,

> "*Central Valley Project, Trinity River Division, California-* The Committee is aware of the Trinity River study addressing the effects of various flows on the anadromous fish populations in the river. The Committee is concerned about the potential impacts on water supply in the Bay-Delta system. As part of the study, the Secretary is directed to minimize the adverse impacts on the Central Valley Project and to ensure that the effects of the flow recommendations from the Trinity River study on the Bay-Delta system are fully assessed within the CALFED process before reaching a decision on implementing study recommendations.[1]"

In fact, the flow impacts of the Trinity Decision were never considered within the CALFED process. It was widely known that the Trinity Decision was pending when the CALFED ROD was finalized, yet there is no discussion of this Decision's cumulative impacts in the CALFED environmental documents.

The increased Trinity flows were not included within CALFED's Environmental Water Account's (EWA) regulatory baseline. Thus, the Trinity Decision is a new Endangered Species Act regulation that is taking water from the users instead of purchasing it from willing sellers, per CALFED's EWA commitment to the water community. The real impact of the Trinity Decision is to intensify the regulatory drought for the water users within the water projects. This is exactly what the regulatory agencies promised would not happen in this era of the EWA.

Finally, the Farm Bureau has grave concerns about the underlying science and the policy decisions that were made relating to fish biology, in particular the Trinity Decision's temperature impacts on threatened and endangered fish within the Sacramento River. Several listed species within the Sacramento River are being sacrificed in order to improve the fish populations within the Trinity. The USFWS and NMFS have issued Incidental Take Statements for these species. However, reconsultation may still be required in dry or critically dry years. We are concerned that the regulatory agencies have not sufficiently considered these impacts or developed policies to maintain appropriate temperatures in the Sacramento River during the implementation of the Trinity Decision.

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[1] H.R. 2605, 106th Cong. (2000) (enacted), H.R. Rep. No. 106-253 (2000).

The regulatory agencies must complete the appropriate National Environmental Policy Act review of the biological opinions that were released on October 12, 2000. And the regulatory agencies should update the original biological opinions for some of the species contained in these October 12, 2000 biological opinions because the entire water system has changed significantly since certain opinions were originally published, specifically those published before 1993.

Mr. STOKELY. Thank you, Mr. Ose, and thank you, Mr. Burton and Mr. Horn. I would also like to thank our representative, Wally Herger, and Mr. Thompson as well, for getting me here today.

Mr. OSE. Well, I will tell you that Mr. Thompson twists my arm, so he is very effective.

Mr. STOKELY. He did? OK. [Laughter.]

It is an honor to be here. As you said, I am a senior planner with the Trinity County Planning Department, and I have worked on restoration of the Trinity River since about 1989. I am Trinity County's lead agency representative for the EIS/EIR that the other witnesses referred to, and I have been working on that project since 1994.

The main points I would like to make today are that the Federal court system is dealing with the Trinity River flow decision, limiting its impacts this year on power, and it will actually provide some minor benefits to power production this summer. Second, delaying implementation of the Trinity River flow decision will not assist in dealing with the energy crisis during the year 2001. And third, the evaluations in the Trinity River EIS/EIR actually show some power benefits from implementing the preferred alternative, particularly for future years, which helps to offset some of the negative impacts of the power implications involved in the Trinity River record of decision.

As far as the courts are concerned, on March 19th Federal Eastern District Court Judge Oliver Wanger issued a verbal preliminary injunction which limited increases in the Trinity River this year to a critically dry year flow, which is an increase of 28,600 acre feet. The no-action alternative is 340,000 acre feet. So that would put the flows down the river this year at 368,600 acre feet.

Therefore, even if the year were to go to a dry year—which, as I understand it, it is a critically dry year now. If it were to go to a dry year, the river would not receive the prescribed flows in the record of decision, which would be 113,000 additional acre feet. And in addition to that, he has directed that a supplemental environmental impact statement be prepared that would deal with the energy crisis in California, as well as issues related to the Endangered Species Act.

And I might add that the Bureau of Reclamation has filed declarations in Federal court which indicates that this additional water going down the river this year will not come out of any CVP water contracts, it will come completely out of storage at Trinity Lake, which is not something that we are very happy about in Trinity County, but it actually is to the advantage of some of the other panelists and their constituents here.

The additional in-stream flows will come out of Trinity Lake storage, and the relationship of that to power production is that the additional 28,600 acre feet of water that is going down the Trinity River this year that would not otherwise be going down the river in the absence of the record of decision, will in fact generate power at the Trinity Dam Power Plant at about 400 kilowatt hours per acre foot. That is approximately 11,000—or, excuse me, 11,440,000 kilowatt hours of energy that is going to be in addition to what would have otherwise occurred this year in absence of the Trinity River flow decision.

In addition to that, there are also some other benefits that we did not analyze in the EIS/EIR. There is a long-term average—the EIS/EIR estimates a long-term average reduction of 7 megawatts. However, there are some other issues that make it not as big as it could have been otherwise. The first one is actually an issue that affects power generation this summer, and that is, in the past the timing of exports from the Trinity River to the Sacramento River has been in the spring months and the early summer months, and that was to protect the winter run chinook on the Sacramento River.

Because of temperature concerns in the Trinity River, what has occurred as a result of the preferred alternative is the timing of the exports has shifted from the spring months to the summer months, and in fact, the peak of the exports or the generation from the Trinity River division will now occur in July, August, and September, and into early October of this year and also in future years. So instead of generating a lot of power during the spring months when it is generally not needed, it will, in fact, be generating power during the peak demand of the summer months. And that is an issue that will occur this year.

Another issue for future consideration, but not necessarily relevant this year, is that the record of decision does result in a reduction of water contract deliveries, and in particular, south of the Delta. For instance, as I mentioned in my testimony, it takes 615 kilowatt hours of energy to pump water up into San Luis reservoir to provide water for the Westlands Water District, which is one of the plaintiffs in the litigation. And with a reduction of water deliveries to Westlands, there is a savings of that 615 kilowatt hours per acre foot, so that helps offset some of the reduction in generation from the flow decision.

A third consideration is that the analysis in the document looked at power plant bypasses as a means of complying with temperature requirements in the Trinity River. And what we actually found is that the preferred alternative has a 9.4 percent frequency of power plant bypasses at Trinity Dam, whereas the no-action alternative actually has a 13.8 percent frequency of power plant bypasses. This is primarily because the temperature compliance in the Trinity River is much improved under the preferred alternative, and therefore it results in less of a need to bypass the power plant at Trinity Dam. Whenever that has been done in the past, it can lead to up to an 85 megawatt reduction in power production because of the loss of generation at Trinity Dam.

So, I would just like to conclude that the record of decision will have minor but beneficial impacts to California's power supply this year. A Federal court is dealing with the issue. It is my understanding that the Interior Department and probably Trinity County will be issuing a supplemental environmental impact statement and report, and will be looking at the power crisis, as well as issues of endangered species. Thank you very much.

[The prepared statement of Mr. Stokely follows:]

TESTIMONY OF TOM STOKELY BEFORE THE CHAIRMAN DOUG OSE'S HOUSE SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND REGULATORY AFFAIRS IN SACRAMENTO ON APRIL 10, 2001

Mr. Chairman, thank you for the opportunity to participate in your hearing. It is an honor to be able to speak to you today. I would like to personally thank Trinity County's Representative Wally Herger for helping me to be on the agenda today.

I am Senior Planner with the Trinity County Planning Department. I have worked on restoration of the Trinity River since 1989 on behalf of Trinity County. I am Trinity County's lead agency representative for the Trinity River Mainstem Fishery Restoration EIS/EIR (Trinity EIS/EIR) which resulted in approval of a Record of Decision (Trinity ROD) by former Interior Secretary Bruce Babbitt and Hoopa Valley Tribal Chairman Duane Sherman on December 19, 2000. I have worked on preparation of the Trinity EIS/EIR since it began in 1994. I am familiar with the analyses in the Trinity EIS/EIR and I am here today to inform you about the implications of that decision on California's energy crisis for the year 2001.

The main points I would like to make today are as follows:

1. The federal court system is dealing with the Flow Decision, limiting its impacts this year on power, and actually providing some minor benefits for power production this year.

2. Delaying implementation of the Trinity River Flow Decision will not assist in dealing with the energy crisis this year.

3. The evaluations in the Trinity EIS/EIR show some power benefits from implementing the Preferred Alternative in future years, which helps to offset some of the negative power implications of the Trinity ROD.

The Courts Are Dealing With The Trinity ROD And Have Effectively Limited It's Impact on Power in 2001

On March 19, 2001, federal Eastern District Court Judge Oliver Wanger issued a verbal preliminary injunction which limited increases in the Trinity River to a "critically dry" year flow of 368,600 acre-feet, which is 28,600 af more than what would have otherwise gone down the Trinity River in the absence of the Trinity ROD (340,000 af). Therefore, even if the water year were to go to a "dry" year, the increased Trinity River flows identified in the Trinity ROD of 113,000 af above the 340,000 af base flows would not be released. The Bureau of Reclamation has filed declarations in federal court which indicate that the additional 28,600 af to be released this year would come out of Trinity storage, not trans-basin diversions from the Trinity River to the CVP.

Delaying the Trinity ROD Will Not Help California's Energy Crisis in 2001

As mentioned above, the additional instream flows for the Trinity River will come out of Trinity Lake storage this year, not trans-basin water exports to the CVP from the Trinity River. Thus, given the amount of water to be exported out of the Trinity River this year, there is virtually no impact to CVP water or power customers in 2001. The relationship of that operational scenario to power production is that it will actually result in an increase in overall energy production at the Trinity Dam Powerplant this year because of increased reservoir releases. This is a benefit to the overall reliability of power in California this year. The reduction in carryover storage is of concern to Trinity County because of our recreational interests at Trinity Lake, but the reduced carryover storage is a slight benefit to power production this year.

The Trinity Flow Decision Will Provide Some Benefits to Power Supplies in Future Years

The Trinity River EIS/EIR analyzed several alternatives, and the impacts of each alternative on a variety of resources, including power resources. While the long-term average impact on power is identified in the EIS/EIR as a 7 megawatt reduction, there are times when the Preferred Alternative would provide a benefit to electrical generation and reliability in California as follows:

1. The Trinity ROD alters the schedule of trans-basin diversions from the Trinity River to the Sacramento River from the spring months to the summer months when electrical demand is higher. The rationale for that change in timing of the exports is to provide compliance with Clean Water Act temperature standards for protection of the Trinity River's salmon and steelhead. Thus, the Trinity ROD shifts power production from the lower demand spring months to the higher demand summer months, an overall benefit to power reliability during the critical summer months of July, August and September.

2. The Trinity ROD causes a reduction of CVP project use power by reducing water deliveries south of the delta. It takes significant amounts of energy (615 kWh net per acre-foot) to pump water out of the Delta and into San Luis Reservoir for use in areas such as the Westlands Water District. This reduction in project use power needs partly offsets the losses of generation from the higher Trinity River flows.

3. The improved temperature compliance in the Trinity River as a result of the Trinity ROD's alteration in the timing of Trinity River trans-basin diversions to the Sacramento River from spring to summer results in a significantly reduced need to bypass the Trinity Dam powerplant to provide cold water for salmon during periods of low reservoir storage. As mentioned in the Trinity ROD, Trinity Powerplant bypasses can result in up to 85 megawatts in lost capacity. The Preferred Alternative was estimated to have a 9.4% frequency of powerplant bypasses during the July through October period. The No Action Alternative was estimated to have a frequency of powerplant bypasses of 13.8%. Thus, implementation of the Preferred Alternative will allow the Trinity Dam Powerplant to run more often that it otherwise would in the absence of the Trinity ROD.

Conclusion

The Trinity River Record of Decision will have minor, but beneficial impacts to California's electrical supply in 2001. A federal court has indicated that a supplemental EIS should be prepared to address concerns with California's energy crisis and the water and power effects of the Biological Opinions by the National Marine Fisheries Service and the U.S. Fish and Wildlife Service. In future years, if fully implemented, the Trinity ROD could result in some benefits to California power supplies and reliability to offset negative power impacts of increased instream flows by the change in timing of the trans-basin diversion, reduced CVP project use power demands, and a decrease in the frequency of Trinity Powerplant Bypasses. Delaying implementation of the Trinity ROD for a year will not help solve California's energy crisis in 2001.

Thank you for the opportunity to address this subcommittee.

Mr. OSE. Thank you, Mr. Stokely.

I want to thank all the witnesses for their brief summaries. I would like to recognize the gentleman from Indiana for 5 minutes.

Mr. BURTON. I have to tell you, Mr. Chairman, I am not familiar with the Trinity River or the problems therein. And I think I will let you ask the questions, and I will just observe. As we go along, if I have questions, I will ask you to yield to me.

Mr. OSE. All right.

Mr. BURTON. Thank you.

Mr. OSE. Thank you, sir. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. This is just a general question of the Bureau of Reclamation. Without endangering species' habitat or environmental protections, is there a way to increase generation from hydroelectric facilities?

Mr. MCDONALD. Probably the only fair answer is that it would be a highly site-specific circumstance that would depend on the species you are dealing with, and the hydrology and hydraulics of the riverine environment you are dealing with. There certainly are places I can point to where we have had those kinds of opportunities by working with the riverine environment, perhaps with the mechanical manipulation of vegetation, that kind of thing. There are other instances I can point to where that could not be done. We simply had to change power plant operations to achieve the required legal protection of endangered species.

Mr. HORN. Well, you have just given us a safe method on at least one situation. How do we implement them, and how do we spread that along in different rivers?

Mr. MCDONALD. Again, it is a highly case-specific situation. There are some instances in which, even though we might have had to change power plant operations, we would have, by virtue of generator upgrades, for example, we have recovered lost capacity. In other situations, we can move water around in terms of its monthly scheduling, and recover generation that might have otherwise been forgone.

In general, as I testified to, I would emphasize that seldom do we actually bypass a power plant. The issue is more one of whether we can meet peak loads because we might have to dampen out a historical peaking operation compared to current requirements.

Mr. HORN. How does the system work here on all the different things that the different Federal agencies think very dearly about, whether it be fish and wildlife, reclamation, Corps of Engineers, all the rest of it? How do we make decisions on this?

Mr. MCDONALD. In the context of Reclamation as an action agency, quote, unquote, under the Endangered Species Act, having legal obligations under section 7(a)(2) to not cause jeopardy to a listed species, or to adversely impact critical habitat, the process calls for consultations with the relevant agency, which might be the National Marine Fisheries Services, or Fish and Wildlife Service. We go through those consultations extensively on operating projects, utilizing the best available scientific information about species. These tend to be very case-specific circumstances that we have to sort through project by project.

Mr. HORN. Does that mean that the decision is not made here in the region? If there is a real difference, it goes back to Washington, DC, and they get those people around the table? Or do they?

Mr. MCDONALD. Anything that I have ever personally been involved in has been a decision at the regional level among regional directors of Reclamation, Fish and Wildlife Service, and National Marine Fisheries Service.

Mr. HORN. And they try to get a consensus out of the group, is that it? And then what happens? What is the directive?

Mr. MCDONALD. Certainly Reclamation's perspective as we work with the consulting fishery agencies is to make our views known and present the science as we understand it. It is our obligation to start with a biological assessment. We will defend what we understand to be the best science, and work with the fishery agencies to try to understand their requirements and their interpretation of the jeopardy standard under section 7(a)(2). In particular, we work with ways to be sure that reasonable and prudent measures are not burdensome on a project, or if we are causing jeopardy and have to go to a reasonable and prudent alternative, to have a reasonable and prudent alternative that meets the conditions of the act and the regulations as to being, indeed, reasonable and prudent.

Mr. HORN. Which agency has the domination over saying OK, folks, we have talked about this for 3 years, can we get this thing moving?

Mr. MCDONALD. It is always the action agency as a matter of law. The statute has a prescribed time line which the action agency can require of the fishery agencies. At the end of the day it is our decision, not theirs.

Mr. HORN. You say it is your decision.

Mr. MCDONALD. As the action agency.

Mr. HORN. As the action agency. And I gather there has been several rules issued through the Bureau of Reclamation that reduce generation capacity for the benefit of environmental protection. So that would have been made by your particular area, is that correct?

Mr. MCDONALD. Yes.

Mr. HORN. Yes. And are there any areas in the process that allow for future forecasting of growth in electricity demand as one of the factors, or for emergency plans for increased generation? So is that in the law in any way electricity, or is it sort of oriented primarily to species?

Mr. MCDONALD. The standards of section 7(a)(2) of the Endangered Species Act, Congressman, do not permit an economic analysis. It is strictly a scientific analysis relative to jeopardy of the species. We certainly always, as an action agency, try to understand those impacts. Instances that come to my mind are those such as the decisions made in 1996 at Glen Canyon Dam, where we did build into our final decision, based on the biological opinion, emergency criteria that allow us, on occasion, to operate outside the boundary of the biological opinion if we face a system emergency.

Mr. HORN. Now, does the Environmental Protection Agency in Washington or the region, do they have a say in any of this?

Mr. MCDONALD. The Environmental Protection Agency is not the regulatory agency. That is either Fish and Wildlife Service or NMFS. But to the extent that you can have water quality parameters as a factor in the health of an endangered or threatened listed species, then EPA can be involved. That will always tie back into the water quality standard of the water body that you are dealing with.

Mr. HORN. Yes. I have a lot of respect for Fish and Wildlife, but I do not have any respect, frankly, for the on science within EPA. When we put it in the law, they refused to bring it to the floor back in 1993. And, you know, we have referred things to the National Academy of Sciences, and that helps, because they do have scientific people. But some agencies, I have a feeling that they just do not really think much about science, and that worries me. Now, do you run into that, where some agencies seem not to really have a decent scientific analysis?

Mr. MCDONALD. I would not characterize it that way. I think the challenge that the ESA always presents to executive branch agencies is that it is an absolute requirement to avoid jeopardy, and in that context, you have to work with the best available science. Often in the biological sciences the best available science is full of risk and uncertainty that cannot be reduced beyond a minimum that leaves a lot of judgment as to indeed what is required by the species.

Mr. HORN. You seem to be very knowledgeable about the law on that, and you noted that electricity and economics are not part of it. I take it that——

Mr. MCDONALD. Not part of a jeopardy standard. No, sir.

Mr. HORN. Yes. Did anything else go? Because it used to be that you could not build a dam unless there was certainly an economic analysis that you could pay back the money for that dam. And you had to go through very specific things in the 1950's and 1960's in terms of crops and what this will mean and so forth.

Mr. MCDONALD. Sure.

Mr. HORN. Did all of that go out?

Mr. MCDONALD. Those are not requirements of the Endangered Species Act under section 7(a)(2).

Mr. HORN. Well, does it have—is it existing still in Reclamation law?

Mr. MCDONALD. Certainly if Reclamation were authorized by Congress to do a feasibility study of a new project, we would apply those economic justification criteria, or, as we call them, the benefit cost analysis, which tries to capture benefits and costs in dollar terms to society as a whole.

Mr. HORN. Well, would that not put on the table the matter of economics, electricity, etc?

Mr. MCDONALD. Sure, if we were planning a new project, it would.

Mr. HORN. OK. So it is not completely thrown overboard.

Mr. MCDONALD. No, sir.

Mr. HORN. OK. Thanks, Mr. Chairman.

Mr. OSE. Thank you.

Mr. Jobson, in terms of the Trinity River decision that Judge Wanger has taken under his jurisdiction, Mr. Stokely was talking about the positive or negative impacts in terms of power generation that will result from the verbal injunction that Judge Wanger—actually, it is not a verbal. It is actually written. It is a temporary injunction that has actually been written.

Mr. STOKELY. It is my understanding it is a preliminary injunction and he issued a memorandum of opinion. But I have not seen a preliminary injunction, itself, yet. But he issued——

Mr. OSE. I actually read it, and I read it as a preliminary injunction pending a final. Anyway, the point of my question is whether or not you agree with Mr. Stokely's conclusions about the impacts on power supply?

Mr. JOBSON. No, sir, I do not. We see that differently, and I will explain. First of all, in 2001 the judge did limit the releases to that which would be made in a critically dry year, rather than in a dry year, which I agree with Mr. Stokely.

Mr. OSE. 28,600?

Mr. JOBSON. Right. And should it have been a dry year this year—and it has not been determined yet—that would have saved approximately 90,000 megawatt hours. The reduced flow would have conserved 90,000 megawatt hours, which is a substantial amount of electricity.

The fact that Reclamation has determined that these additional releases to the Trinity, even if it is only 28,000, will be made solely from storage merely delays the impact on power and water. It means that Trinity reservoir will be lower. It means that the power plant will therefore have less capacity and produce less energy and it means that we will likely not recover its full storage next year or will be less likely to. So those are delayed impacts, they are not benefits.

In addition, any generation that will be added at Trinity Power Plant as a result of this 28,000 acre feed, generation at the remaining Trinity River division plants, Carr and Spring Creek Power Plant, and at Shasta Power Plant—I mean, excuse me, at Keswick Power Plant in the Shasta division will be lost, because the releases from Trinity will not be diverted across to the Sacramento River, they will go down the Trinity River.

Mr. OSE. Before you leave that issue, is that a one-for-one? I mean, I am trying to understand. I understand you cannot drink the water twice, so to speak.

Mr. JOBSON. No. I understand.

Mr. OSE. But is it a one-for-one? If you go down Trinity, you lose 1 megawatt hour, or if you go down the other way—I mean, is it a one-for-one?

Mr. JOBSON. Let me explain.

Mr. OSE. All right.

Mr. JOBSON. In either case the water is released at Trinity, and it generates approximately 400 kilowatt hours an acre foot at Trinity Power Plant. However, after that, going down the Trinity River there is a very small, almost inconsequential power plant at Lewiston Dam. But, basically you are dealing with about 400 kilowatt hours per acre foot as a generation in that alternative.

If it is diverted to the Sacramento River, an additional 1,100 kilowatt hours per acre foot will be generated on top of the 400, due to generation at Judge Carr, Spring Creek, and Keswick Power

Plants. So, it is about a three-to-one difference. A total of 1,500 kilowatt hours per acre foot if it is diverted to the Sacramento River, and 400 kilowatt hours plus change at Lewiston it if is released to the Trinity River.

Mr. OSE. Do you agree with that, Mr. Stokely?

Mr. STOKELY. I agree with his numbers. The only thing I disagree with is that the water that will go down the river this year will come out of storage. As I understand it, it is not water that would have been sent over to the Sacramento River to produce that 1,100 kilowatt hours per acre foot, it is water that is coming out of storage, and if we do not have a wet winter next year, there may be or there will be an impact next year. If we have a wet winter and we have what we call safety-of-dams releases, there will virtually be no impact in future years because the reservoir will fill up, but we do not know that.

Mr. OSE. I am just trying to get clear in my mind, as we move forward to try and find solutions, is it a one-to-one swap, is it a one-to-two, is it a two-to-one. And I appreciate—I mean, you guys are agreed on that ratio, though, in terms of the power generation?

Mr. STOKELY. Yes.

Mr. OSE. OK.

Mr. JOBSON. There were a couple of other areas that I found that I viewed differently. Characterizing the capacity lost as an average of 7 megawatts is misleading. Capacity is measured in dry years by hydroelectric plants as their capability to produce in dry years, standard industry approach. An average capacity is almost a contradiction in terms. Capacity is measured on what can be relied on in all circumstances, and with a hydro project, in dry circumstances. That impact on the Trinity River decision is 150 megawatts in a critically dry year and the cumulative impact, with implementation of CVP Improvement Act, is 325 megawatts in a critically dry year. That is how the capacity should be measured.

Mr. OSE. So, in terms of a system-wide situation, the record of decision signed by the secretary in a critically dry year would cost us 300-and-some-odd megawatts of power generated?

Mr. JOBSON. That is the cumulative impact with Trinity and CVP Improvement Act.

Mr. OSE. OK.

Mr. JOBSON. CVP Improvement Act has been implemented, so that is the number, but if you just look at the increment of Trinity, it is 150.

Mr. OSE. Let us focus just on the Trinity, because that is what Mr. Stokely came to testify about.

Mr. JOBSON. 150 megawatts.

Mr. OSE. OK, great.

Mr. JOBSON. The other thing I would point out is that I think the timing benefits of moving generation around are overrated, that there are still impacts—adverse net significant impacts on power of the secretary's decision, unless it is substantially changed when he revisits his decision in the supplemental environmental document. And we hope that this administration will employ a more open process where our alternative—the power alternative is given a much more fair shake. We took a lot of time and hired experts, PhDs in their field, to develop an alternative that employs water conservation as well as fishery restoration, and we hope this administration gives it a fairer shake than the last one did.

Mr. OSE. My time has expired. Mr. Horn.

Mr. HORN. I yield back.

Mr. OSE. OK, I have more time. Ms. Sheehan, I just want to visit with you about the consequence to the members of the Farm Bureau that is likely to occur this summer, and for that matter beyond. To the extent that we do not have enough power, from your perspective, what are the consequences to the agricultural community up and down this State?

Ms. SHEEHAN. Well, as you know, agriculture is having a real tough go of it right now. The industry is under a lot of pressure. The agricultural markets are struggling. Agricultural regulations are getting stricter every year. We have had numerous decisions reducing the water that is available for use by agriculture. Water has been converted from agricultural use to environmental purposes.

Now with the energy crisis on top of all these other stresses on the industry, it is already becoming too much for many of our farmers, and a lot of people are looking for relief. Once we lose our valuable agricultural infrastructures, our agricultural land is going to be converted to urban uses. We are going to lose our industry, our agricultural industry. We have already lost many packing plants. It is a steamroller effect. Once you start losing the processing plants, even though the land is there, you cannot make any kind of profitable agricultural use of the land.

Mr. OSE. It is interesting. As I drive up and down the valley, one of the dynamics that I see at play is that, for whatever reason, things change. I mean, it is a very dynamic economy. As it relates to our rice growers, by virtue of a decision taken by the legislature, they have moved away from what I would call a traditional rice burning or rice straw burning template, to using water to deteriorate the straw in the fields. I have to admit that I look at the water in those fields, and I see power behind the dams. I am wondering about the tradeoffs, whether or not that particular issue was ever considered in the context of the original legislation for particulate matter from the rice straw burning.

Ms. SHEEHAN. I do not believe it was, but it is not my area of expertise. I was not involved in making this decision. I was not involved in the development of this legislation. The energy situation is so new right now, I do not think it was on anyone's radar screen even a year ago. So, I do not believe that impact was considered.

Mr. OSE. I am trying to find the right balance, is what—I mean, Trinity River, Sacramento River, Shasta, all of these different components play a piece here. To the extent we have a surplus of this and a deficit of that, how do we use the surplus to meet our deficit? I just cannot help driving up and down I–5 looking at the rice fields. My gosh, that is power behind a hydro dam.

So, Mr. McDonald, over on the Colorado, is that Bureau or Corps of Engineers operated?

Mr. MCDONALD. If you are talking power plants, they are all Bureau of Reclamation.

Mr. OSE. OK. First of all, I want to pay a compliment to you and provide a little constructive feedback, if I might. Your Web site is very informative.

Mr. MCDONALD. Oh, thank you.

Mr. OSE. I appreciate being able to go there.

Mr. MCDONALD. I will pass that on to our computer gurus.

Mr. OSE. The constructive feedback I would give you is that the totals you have on the 58 different plants are aggregates for the month rather than—there is no place I can go and say well, what are we producing today.

Mr. MCDONALD. Oh, I see what you mean.

Mr. OSE. It would be helpful to me, watching the power situation in the West, to have kind of like today's production, month-to-date number, with a historical perspective. So I pass that on as constructive feedback.

Mr. MCDONALD. Fine. I will see if it is doable.

Mr. OSE. Now, the issue in particular on the Glen Canyon is that last May or June, if I recall, we came across a piece of legislation that was passed through Congress and signed by Bush 41 to implement a low flow of release experiment from Glen Canyon. I have to admit some respect for—significant respect for the people who crafted the legislation, because imbedded in the legislation is authorization for the Secretary of the Interior, under emergency conditions of one sort or another, to waive the requirements of the low flow experiment, and ramp up the generation from Glen Canyon. Are you familiar with this particular issue?

Mr. MCDONALD. Yes.

Mr. OSE. I noticed in your testimony you have a chart here. It has got both Hoover and Glen Canyon.

Mr. MCDONALD. Yes.

Mr. OSE. What I am trying to figure out is the conditions under which the Department now waives the continuation of the low flow release experiment. In other words, is it a stage 3 in Sacramento—or in California? Is it a stage 3 west of the Rockies? Are there any definitions so that when we get to a certain point it is automatic, rather than having to be a new administrative act?

Mr. MCDONALD. There are definitions, Congressman. They are spelled out as part of the 1996 decision on the operation of Glen Canyon Dam. Basically, we will deviate from the requirements of that decision in instances in which a system has crashed and needs to be brought back up, there is a loss of transmission and we need to stabilize the system, or there is a loss of generation and the system needs to be stabilized.

There are a series of criteria that are actually set out in that decision. If I could summarize those briefly. Basically, Western Area Power Administration, the marketer of the power, has to decide that the utility that is seeking assistance—and in the context of California it is the ISO that calls up Western—has exhausted all their reserve capacity, that there are no non-firm energy sales out there to be had, that all interruptible loads have been shed, and that a blackout condition on the system is imminent, which in the context of stage 3 brings us below a reserve of 1½ percent. If that kind of request is received from the ISO, as it has been several times in the last several months, and if—and this is the biggest if—there is transmission capacity available from Glen Canyon Dam into southern California, we, Reclamation, have responded. In my written testimony I identify the four times where transmission capacity was found by Western, we could sneak electrons through Arizona, if you will, and we were able to get power to California. In the other instances there was simply no transmission capacity.

Mr. OSE. This brings me to my fundamental question, and that is, as we look for solutions to California's energy crisis, I mean, power is often fungible within certain parameters. I mean, power from Glen Canyon can go east or west, north or south under certain parameters. How do we make it possible so that in a situation of an emergency nature we can run Glen Canyon up or run Hoover up and get that power in here?

Clearly you have indicated we need transmission lines or transmission capacity. Yet, you have also indicated the Bureau does not own transmission capacity. Are there programs that we could undertake or policies we could adopt that would facilitate the creation of that transmission capacity?

Mr. MCDONALD. Two comments. First of all, transmission is not a constraint at Hoover. There is ample capacity, transmission capacity, to move power generated from the Hoover-Parker-Davis complex into southern California. There is essentially no limitation at Hoover on our peaking ability, because the two downstream reservoirs provide re-regulation of releases from Hoover. The limitation at Hoover is the interstate compact and the international treaty which we have to observe or we are wasting California's water. At Glen Canyon it is a different situation.

Mr. OSE. Do not do that. Do not do that.

Mr. MCDONALD. I understand. At Glen Canyon, a different situation. We lack the transmission capacity. It would take a private utility or Western Area Power Administration, with congressional authorization, to construct new transmission capacity. But it would also take some changes in Federal law that I need to point out.

Glen Canyon was authorized and is operated pursuant to the Colorado River Storage Project Act of 1956. Pursuant to that act, the surplus power from not just Glen Canyon, but the whole of the Colorado River Storage Project system is marketable to customers in Wyoming, Colorado, Utah, New Mexico, Arizona, and Nevada, and only in those States. All of this surplus power is in fact under contract, and there is nothing else available. All Glen Canyon can do, even if there were transmission capacity, in the context of those Federal statutory requirements, is run some water through the generators on a peaking basis, losing water that would otherwise be held to generate for those customers. Then, Western has to go out on the market and buy replacement power which those customers have to pay for. So essentially, Glen Canyon is simply not available except in the kind of very constrained emergencies that we have already, and will in the future, continue to respond to.

Mr. OSE. In terms of those other States into which Glen Canyon might send power under the compact, are there alternatives for California? In other words, I mean, it is the fungible nature of the electricity I am trying to get to. Maybe this person is generating capacity into California and the market changes, and then he is going to—that person is going to go there and somebody else is going to fill the gap. Are there things we can do operationally to maximize the fungibility of the power? In other words, send Glen Canyon east and bring somebody else west?

Mr. MCDONALD. Sure, it is certainly fungible. It basically boils down to the transmission constraint. If you use that water at Glen Canyon to generate power for other than Western's customers, then Western has got to go into the marketplace. The volatility of the marketplace, of course, has got them up against the same problem that the private utilities in California are up against.

Mr. OSE. Well, that is at the heart of the question because Western delivers to any number of smaller retailers here in California, whether they be municipalities or otherwise.

Mr. MCDONALD. That is correct.

Mr. OSE. The price of alternative or substitute power on the spot market is absolutely hammering them in trying to replace that. So, again, I am looking for suggestions as to what we can do at the Federal level, even if it is Glen Canyon or Hoover or somewhere else, to facilitate the delivery of power into California for those gaps. You are saying very clearly you need transmission facilities?

Mr. MCDONALD. Transmission and interties are probably the two keys.

Mr. OSE. OK. It does not matter whether they go north, into northern California, or into Nevada or Utah. The market will just level that all out in terms of providing extra power where it is needed?

Mr. MCDONALD. If we continue to have that kind of market into the future. Obviously, that is the subject of your hearings and what California State agencies may do as they address all of these issues. But headed in the direction it is, yes, it becomes a more fungible product.

Mr. OSE. My time has expired. Mr. Horn.

Mr. HORN. Just one question that relates to Hoover Dam, Mr. McDonald.

Mr. MCDONALD. Yes.

Mr. HORN. Has the argument—when they formed the percentages between Nevada, Arizona, and California, it was a very dry period of years. Has the Bureau of Reclamation looked at that in terms of what the percentage would—the percentage would remain the same, but there would be a lot more based on how wet the history was when that was put into the treaty or compact between these States.

Mr. MCDONALD. I think there are two different issues there, Congressman. The amount of water apportioned among the States is based on the 1922 Colorado River Compact. With the virtue of hindsight, they did look at a period of record that was probably one of the wettest periods on record. The States have never chosen to attempt to renegotiate that deal.

The power issue is different. That is not imbedded in the compact, it is an act of Congress that directed the marketing of power, 50 percent to California, 25 percent each to Arizona and Nevada. That did not turn on the history of the water supply in the Colorado River.

Mr. HORN. What year was that power——

Mr. McDONALD. That is provided for by the authorizing legislation for Hoover Dam. So, the authorizing act of 1928.

Mr. HORN. Yes. Well, you have got Las Vegas that has 10,000 people coming in—depending on who you talk to—a week, a month. And added up to a year or so, I think you will find there will be a pressure for water out of Hoover Dam. I do not know what Reclamation is seeing in Nevada that might help that situation, because they are going to really be up against it. Arizona has not really started to get its share of the water. It is available, but they have not used it that much. So, what does Reclamation think looking ahead?

Mr. McDONALD. To give a short answer to a very complicated situation, the issue of the use by California of its compact entitlement and its apportionment under the Supreme Court decree of 1963 in *Arizona* v. *California* has been the subject of much discussion in the last several years, leading to a decision that the Secretary of the Interior just made late last year, under his statutory authorities, relative to bringing California back down from its current use of about 5.4 million acre feet a year, to its entitlement of 4.4 million acre feet a year. Associated with that was another Secretarial decision, under Federal statute, as to how, when there are surplus conditions in the Colorado River system, the Secretary will arrive at a decision to declare that surplus. So, in fact, the longstanding dispute among the seven States has been, I hope, knock on wood, brought to a conclusion in just the last several months.

Mr. HORN. Well, we have our friends in Mexico that——

Mr. McDONALD. Who are raising a number of new issues that will take our attention for a number of years to come, I am sure.

Mr. HORN. Yes. Well, we have got two Presidents that like each other for the first time in history, and I know the Mexican people certainly would like to have a little better situation than we have, and it is a lot better than it was in the 1950's and 1960's when we were just sending salts and all the rest down to kill some of their plants. And I think a lot of that has been slowed down and stopped, has it not?

Mr. McDONALD. The United States is complying with what we call Minute 242, which deals with water quality. Minute 242 of the International Boundary and Water Commission. We have complied with that minute every year since it was agreed upon by the two governments. So we are meeting the water quality standards for salinity.

Mr. HORN. Mr. Chairman, I would like to have the Secretary's decisions that were referred to by the commissioner, and put them at this point in the record.

Mr. OSE. Without objection.

Mr. McDONALD. Be glad to.

Mr. HORN. I yield back.

Mr. OSE. Let me go back to transmission questions. Down in the south part of the valley—and I do not know who might be able to answer this—Path 15.

Mr. JOBSON. I can speak to that.

Mr. OSE. Apparently we have two-thirds of the capacity we need for transmission at a certain point.

Mr. JOBSON. There is a bottleneck on the north-south 500 KV inter-tie in California called Path 15, and it is a spot where there are two, rather than three, 500 KV lines. A third one is necessary in order to relieve the bottleneck.

Mr. OSE. How do we get it?

Mr. JOBSON. Well, it needs to be designed, constructed, and built. The Transmission Agency of Northern California had offered to go forward, and if forwarded money from the State of California, as I understand it, go forward and get the biological studies done this spring as soon as possible, and take a leadership role in facilitating the construction of that line, so long as there were interested parties with the funding to do it.

Historically, the TANC, the Transmission Agency of Northern California, and the Western Area Power Administration have played a lead role in building the last 500 KV upgrade on the north-south inter-tie, and that is the COTP, California-Oregon Transmission Project. I think the publics will stand willing and ready to contribute whatever services we can to resolving that bottleneck, as it will help resolve a portion of the reliability problems in the State.

I did also want to mention, with respect to public power, that a topic came up in the last panel about supplying information and municipals' role and that type of thing. And if it pleases the chairman, I want to add a bit to the record on that.

Mr. OSE. Feel free.

Mr. JOBSON. SMUD and other municipals have made it clear that we will voluntarily comply with any caps that apply to all market participants. We largely are buyers. We are consumer representatives. We serve load. We will voluntarily comply with those caps, and voluntarily provide any other information that other market participants are required to provide. So we do not believe the jurisdictional differences will be a constraint to our participation in resolving these problems.

Mr. OSE. Let me dwell on that for a moment. In terms of SMUD's efforts to acquire long-term source supply for that portion that they do not generate themselves——

Mr. JOBSON. Right.

Mr. OSE. [continuing]. How long does it take you to finalize it? SMUD is not subjected to PUC's directive on long-term contracts?

Mr. JOBSON. Correct. We have a number of long-term contracts, the largest of which is with the Central Valley Project. But we have a number of other contracts, and are developing others as we speak, to mitigate our long-term risk. We have continued to do that, and are stepping up some of those efforts. So, how long does it take? Say you are talking a 10-year contract, that can be brought from beginning to end in a period of 6 months or less, if necessary.

Mr. OSE. Do they work pretty well?

Mr. JOBSON. Yes. We have had long-term contracts with suppliers in the Northwest which we have imported over our COTP line for years, many years, with a variety of suppliers.

Mr. OSE. But it is an option that is available to SMUD, it is not a mandate?

Mr. JOBSON. Definitely.

Mr. OSE. It is just an option?

Mr. JOBSON. No. It is a tool that one uses to diversify ones risk.

Mr. OSE. Right.

Mr. JOBSON. And not keep all your eggs in one basket. So SMUD, for instance, generates about half the power we serve to our customers. We buy the other half from a variety of long and short-term contracts, primarily longer-term.

Mr. OSE. Different trenches?

Mr. JOBSON. Yes, exactly.

Mr. OSE. All right.

Mr. JOBSON. Risk diversification. That is what it is. But our regulatory scheme is different from the investor-owned utilities. We are directly accountable to our customer owners through an elected board. They approve these decisions. And so it is a little more, I think, timely and easy to reflect the local community's desires.

Mr. OSE. I doubt if your cash-flow requirements differ greatly from the IOUs, though you have got to have cash to pay your bills.

Mr. JOBSON. Definitely.

Mr. OSE. And, you have got to hedge your risks to make sure you minimize your exposure.

Mr. JOBSON. Right. We also approve our own rate increases rather than going to the PUC. So that helps somewhat with respect to the cash-flow. But, you know, the other large difference is we operate without profit. We pass through whatever our power costs are. It has allowed us to not raise our rates in 10 years, although you will see that changing here in the next few months.

Mr. OSE. Your rates are higher or lower than the investor-owned utilities at present?

Mr. JOBSON. Lower.

Mr. OSE. Yours are lower?

Mr. JOBSON. Correct.

Mr. OSE. By what percent?

Mr. JOBSON. It is not my field of expertise, but I would estimate approximately 20 percent.

Mr. OSE. So, if I read the testimony correctly, the investor-owned utilities you are given a profit margin of 11.6 percent, and you are 20 percent below them?

Mr. JOBSON. Approximately. It may even be more than that, especially with what is going on lately. This is a realtime——

Mr. OSE. Is there a connection between the optional tools that are available to you as opposed to the investor-owned utilities, and the ability of you to provide bargain-basement rates?

Mr. JOBSON. I think it is an advantage to have regulatory flexibility and direct accountability to your ratepayers, so that, for instance, we do not have to do what Los Angeles does. We do not have to adhere to a set of requirements from a common regulator, as Los Angeles—like, for instance, Edison and PG&E do to the Public Utilities Commission. We are directly——

Mr. OSE. DWP does not, either, though.

Mr. JOBSON. No. That is what I am saying. L.A. is responsible to its customer owners through its city council or whatever mechanism it has, and SMUD is responsible to our customer owners. The same with Northern California Power Agency cities. We have more flexibility, and are able to tailor our risk management, our rates, our resource decisions directly to what we feel and our customer owners feel is appropriate. SMUD, for instance, has a high amount of demand-side management, environmentally friendly resources, renewables, because that reflects what our customers think is the right thing to do. And they express that through a vote, and they elect board members, and we immediately, within our own district, make these decisions.

Mr. OSE. All right.

Mr. JOBSON. We think that is a better model, and we think our rates over the last—as long as we have been in business, reflect that.

Mr. OSE. You like having those tools available at your option to use?

Mr. JOBSON. Definitely. And we like having the accountability to our ratepayers directly for it.

Mr. OSE. So you tell your ratepayers the contracts you enter into, so that they know and can vote accordingly?

Mr. JOBSON. All long-term contracts are approved by the board. The board is elected by the people, and they are approved in open, public meetings.

Mr. OSE. How long of a timeframe between the time you enter into the contracts and the time you disclose the basis of the contract?

Mr. JOBSON. Once the contract is approved by the board it is a public document. The time between which negotiations start and it gets approved could vary anywhere from 1 to 6 months, or considerably longer, depending on how hard it is to negotiate a deal. But, depending on the urgency, it can be done within a matter of months, a few months.

Mr. OSE. Once you commit the ratepayer, you disclose it?

Mr. JOBSON. Before we commit the ratepayer, we disclose it to the—the board's decision is what commits the utility.

Mr. OSE. OK.

Mr. JOBSON. And the board's decision is made in an open meeting. And once the decision is made, it is a public document.

Mr. OSE. All right. Mr. Horn.

Mr. HORN. It is all yours.

Mr. OSE. All right. You are finished?

Mr. HORN. Right.

Mr. OSE. All right. Mr. McDonald, do you have any sense of the cost to complete path 15—or for that matter, Mr. Jobson—of the cost of putting that third 500 KV line in there?

Mr. MCDONALD. I have no idea. Reclamation is not in the transmission line business anymore.

Mr. OSE. OK. Mr. Jobson.

Mr. JOBSON. I can tell you that the California-Oregon Transmission Project cost about $480 million. Now, that is a substantially larger, longer project. But I would think it would be on the order of—you know, this is a guess—$200 million, something like that. We can get back to you with facts on that. It has been costed.

Mr. OSE. I would be interested in what you would estimate the cost of construction for removing this bottleneck would be? All right?

Mr. JOBSON. We will refine that $200 million estimate with contact with your staff, if that is OK. But that would give you an order of magnitude of what we are talking about. So I do not know how many days of power supply that is in California today, but it is not very many.

Mr. OSE. Let us think in terms—at some point we have to have this solved. How do we get there? That is what I am trying to get to.

Mr. Stokely, on the Trinity River issue—and I am willing to be corrected on this. I am asking because I do not know the answer.

Mr. STOKELY. Sure.

Mr. OSE. The record of decision selected an alternative that it is my understanding was not the preferred alternative.

Mr. STOKELY. It did select the preferred alternative, which is the Trinity River flow evaluation, plus additional watershed restoration work. So the record of decision did select the preferred alternative.

Mr. OSE. What is the reason—I mean, again, I read Judge Wanger's preliminary injunction, and he was not too subtle about his concerns there. I am trying to understand, were there things beyond just release of water that Judge Wanger thought should have been incorporated into the selected alternative?

Mr. STOKELY. No. Actually, I believe on page 54 of his memorandum he indicated that the two issue areas he was ruling on that had a chance of success or had merit at a full trial are the issue of the impacts of the two biological opinions on water and power in California. That is, the National Marine Fishery Services' biological opinion on the Sacramento chinook species, as well as the steelhead in the Central Valley and the Trinity River coho. And in addition to that, the U.S. Fish and Wildlife Services' biological opinion on various species under their jurisdiction.

Primarily, one of the main areas that he ruled on was that the biological opinions came out concurrently with the final EIS/EIR, so there was no analysis of the effects of those biological opinions on the operations of the CVP. And then, in addition to that, he basically said that the issues related to the power crisis in California necessitated preparation of a supplemental EIS.

Mr. OSE. Now, this is still before Judge Wanger, so there may be additional rulings and the like to refine the ultimate disposition of this matter?

Mr. STOKELY. Again, maybe Mr. Jobson can correct me, but it is my understanding that memorandum he issued was sort of the framework for the preliminary injunction, and then he ordered the plaintiffs to prepare the actual primarily injunction itself. And as far as I know, he has not signed that order yet, but it is pretty well laid out.

The two issue areas that I am aware of that he ruled did not have a high likelihood of success at a full trial, I think there is three of them, and two of them that I can remember. One is the issue of alternative development. He basically ruled, on page 54 in a footnote, that was not likely to prevail in a full trial. And the other issue was the concept of the healthy river, which was incorporated.

Mr. OSE. I did notice he told the plaintiffs, if I recall, the first challenge he did not think would stand review, but the second—I thought it was very interesting the way he juxtaposed it. Anyway, Mr. Jobson.

Mr. JOBSON. Mr. Stokely and I do not interpret that memorandum the same way with respect to the characterization of what issues may prevail and which may not. I think the salient point from the memo is that there were two things that had to be demonstrated in order for an injunction to be issued. One was irreparable harm if it is not issued, and the other one is a likelihood of prevailing on the merits on any of the issues raised. He concluded that there was sufficient merit on some of the issues, and did not rule on the merit of the other issues. That is our feeling about the memo. Although it will be the order that will be the one important ruling document that he issues, so it may not be an important distinction.

Mr. OSE. All right. I have one final thing, Mr. Horn, if your patience abides.

Mr. HORN. My patience is long-going.

Mr. OSE. All right. Well, you have been patient for 2½ years. I appreciate it.

Mr. HORN. You have been patient in my hearings, so go to it.

Mr. OSE. One of the things my staff and I are giving consideration to is legislation obviously. One of the pieces of legislation we are giving specific consideration to is trying to find a way under which—the circumstance in which a Governor declares an emergency to authorize either the Secretary of the Interior, in the case of the Bureau, or the Secretary of the Army, in the case of the Army Corps of Engineers, the discretion to waive restrictions on operations of facilities.

Do any of you have any input as to how that might transpire? Mr. Stokely.

Mr. STOKELY. In the Trinity River record of decision it does reference development of an emergency operations plan for the Trinity River division of the CVP. And as I understand it, Reclamation submitted a plan to the court as part of the evidentiary proceeding in the—I do not really know the status of that particular plan. Maybe Mr. McDonald could explain it more. But as I understand it, the Trinity River Division has already operated under emergency criteria to provide power to California during some of the stage 3 alerts. And, as I read it, it basically allowed them several hours, if there was a request similar to what Mr. McDonald had described with the Colorado River project, if there was a request for power because they knew there was going to be a shortfall, that the project would be allowed to release water to generate additional power. I really do not know any more than that, but there is apparently some sort of an emergency operations plan. I maybe did not answer your question completely, but——

Mr. OSE. Maybe my question more specifically is, using the threshold of a declaration by the Governor to determine the circumstances under which the Secretary of either Interior or Army would then be able to act. Is that an appropriate standard? That is, for the Governor's determination?

Mr. STOKELY. I am really not prepared to answer that question.

Mr. OSE. OK. Ms. Sheehan.

Ms. SHEEHAN. I am sorry, I do not know the answer.

Mr. OSE. OK. Mr. Jobson.

Mr. JOBSON. The concept of mitigating lost power by having emergency procedures is at best limited, and at worst delusionary. Any water that is expended in an emergency reaction will then not be available for future use. And so it is kind of mortgaging your future with your present. So it should be viewed carefully. And I will note a distinction. In Glen Canyon you will have a situation where there is a lot of undispatched capacity which could be used. In the CVP, because we have regulating reservoirs, there is not a lot of undispatched capacity unless you start dipping into your future supplies. And if you did that every time there was an emergency in California, by the end of the year you would have no water left for next year.

Mr. OSE. You are eating your seed corn, is what you are telling me?

Mr. JOBSON. Exactly. So I think the important thing is to make the right decision on Trinity, one that includes water conservation wherever possible, so that we do not have to delude ourselves with the fact that emergency procedures might work. It is just a mortgage, is all it is.

Mr. OSE. Mr. McDonald, do you share that cautionary note?

Mr. MCDONALD. You know, the usual duck for those in the executive branch, until the administration would take a position, I cannot really comment. I think Brian makes a fair point on the mechanics, though——

Mr. OSE. OK.

Mr. MCDONALD [continuing]. Just as a matter of fact. The other thing I would observe is, where we have made decisions already and have some set of criteria in place such as we have at Glen Canyon Dam or we are working on, as Mr. Stokely pointed out for Trinity, you need, as you craft language, to be precise about whether you are intending to overcome some such preexisting criteria that have been decided upon.

Mr. OSE. Right.

Mr. MCDONALD. And if so, under what circumstances, if not, under what circumstances.

Mr. OSE. Right.

Mr. MCDONALD. I otherwise think you might create substantial confusion.

Mr. OSE. All right. I want to thank the four of you for joining us today. We very much appreciate your participation, as we did the previous panels. We are going to leave the record open for 10 days here. We are headed from here to San Jose. We will convene tomorrow morning at 10 a.m. in San Jose. And with that, we are going to adjourn.

[NOTE.—The report referred to entitled, "California's Electricity Options and Challenges, Report to Governor Gray Davis," may be found in subcommittee files.

[Whereupon, at 4:17 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Testimony of

George Fraser

General Manager

Northern California Power Agency

Before the

House Government Reform Committee

Field Hearing

On the

California Energy Crisis

April 10, 2001

Sacramento, California

Mr. Chairman, the Northern California Power Agency (NCPA)[1] appreciates the opportunity to assist the Subcommittee in unraveling the California energy maze and crafting policy responses to the current crisis. In addition, our statement will address issues involved in the Trinity River EIS/EIR and Record of Decision.

Today, in California, we are struggling to develop solutions that will get us beyond the mistakes that have been made in restructuring the electricity market. NCPA has long supported steps to foster and promote sustainable and effective competition in the wholesale electricity market. Regrettably, the market conditions needed to sustain effective wholesale market competition are not present in California. It will take time, courage and coordinated state and federal efforts to develop and implement both the near-term stopgap protections and the long-term solutions. NCPA looks forward to working with our colleagues in the industry, the State, Congress and FERC to advance the necessary measures to ensure a reliable and affordable power system.

Causes of the Current Crisis

While there is no value in finger pointing, it is clear that many factors contributed to the current crisis – a crisis that spills beyond California's borders and infects the regional power market. At its core, the California and associated Western power markets lack the conditions necessary for a competitive market: multiple sellers, ease of entry, free flow of commerce and price transparency. In California:

[1] NCPA is a nonprofit California join powers agency established in 1968 to generate, transmit, and distribute electric power to and on behalf of its fourteen **members:** cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alton, Redding, Roseville, Santa Clara, Ukiah, the Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District; and seven associate members: cites of Davis, Santa Barbara, ABAG Power, Bay Area Rapid Transit District, Lassen Municipal Utility District, Placer County Water Agency, and the Plumas-Sierra Rural Electric Cooperative serving nearly 700,000 consumers in central and northern California.

- There is a **shortage of installed and operable generation** in California. This shortage has allowed market participants to withhold generation, strategically bid and game the system to maximize profits.
- There is a **shortage of transmission capacity within the State**. Alleviating current transmission constraints between northern and southern California would have prevented the recent rolling blackouts. However, no party has both the responsibility and authority to relieve such constraints.
- There is a **shortage of transmission capacity to import electricity** products from outside California.
- The **absence of a seamless, independent regional transmission system** impedes commerce and narrows the relevant market.
- From its inception, **the Cal ISO and PX lacked the proper rules, procedures and mechanisms to promote competition**, monitor market conditions and take corrective action.

Market forces can only serve to check prices when competitive market conditions exist. In the absence of such conditions, sellers are able to dictate prices without suffering competitive responses that reduce sales and revenue. Whether generators in the state collected scarcity rents or excess profits, the result is the same: power prices that can devastate the economy. As recent experience in California demonstrates, market based rates only work when competitive market conditions exist.

California Municipal Utilities Harmed by Dysfunctional Market

The general perception is that California's municipal utilities have been insulated from the volatile market. While it is true that California's municipal utilities retained the generation assets needed to serve load, our consumers have been far from insulated from the dysfunctional market. NCPA and its members:

- Voluntarily participated in the Cal-ISO load curtailment programs and have been subject to rolling blackouts – even though we had sufficient resources to meet our native load. The consequences for our consumers have been severe. For example, a silicon chip manufacturer in one of our member communities may be pursuing bankruptcy due to the recent January rolling blackouts. These blackouts caused their furnaces to shutdown and stopped development of the silicon chips that caused them to lose $2.7 million of product.
- Have drawn down the reservoirs at our hydro projects to help meet the electricity demands of the state, putting at risk our ability to generate power at these projects during the critical peak Summer months.
- Operated gas-fired combustion turbines at the sole direction of the Cal-ISO, using 20 percent of available air emissions in the first 20 days of January (at a time when the plants would usually not operate) – again reducing our ability to operate the plants during the Summer.
- Purchased power from the market at rates above what would exist in a truly competitive market. One NCPA member, the Lassen Municipal Utility District, faces a 160% retail rate increase as a result of the high price of its market purchases. While NCPA has sold surplus energy in the market, we are net purchasers and should not be punished for what benefit we may receive when we sell surplus energy. To do anything else is fiscally irresponsible for our citizen-owners.

- Sold power to the Cal-ISO, for service to the state's investor-owned utilities, for which we have since been told we will not be paid.

As consumer-owned utilities, the effects of these developments will be felt directly and exclusively by our consumers. We have no stockholders to "share" in the pain.

<u>California's Efforts to Right the Ship</u>

As outlined above, there are many factors contributing to the current crisis. The State has taken, or is considering, a number of short and long-term actions to address the current crisis. I would like to share with you my views on those proposals.

1. Supply Side Improvements

All parties agree that California desperately needs generation additions. State siting laws, emissions limitations, investor uncertainty, and public opposition have all contributed to the inadequacy of current generation resources.

However, NCPA and its member utilities have built, and will continue to build, desperately needed generation resources. The Lompoc municipal utility, located in Santa Barbara County, is looking at building a plant in cooperation with NCPA. In the Bay Area, several municipal utilities are looking at new resources. It is not impossible to build new resources. In order to succeed, project developers must exhibit both environmental and community sensitivity, and advance smart, cost-effective technology choices.

The Governor's Executive Orders streamlining the siting process and providing greater flexibility in air emissions are important first steps – to maximize use of existing resources, jump-start generation additions, and show that the State is committed to adding generation. California municipal utilities believe these efforts can go farther. For instance, the short-term waivers of hourly emissions limits apply only to those plants under contract with the State Department of Water Resources. We believe the waiver should be expanded to include generation units owned by municipal utilities that are not under contract with the Department.

2. Energy Conservation Efforts

The Governor and the State Legislature are pursuing important energy conservation efforts. Demand reductions are the quickest way to meet our energy needs for this summer, and it is incumbent on all parties to take part in this effort.

With service to more than a quarter of the State's consumers, municipal utilities are reducing their customer load and pushing for a proportionate share of state conservation funds to allow us to assist our consumers in reducing energy demand even further. NCPA and its members implemented broad conservation efforts for the summer of 2000, well before most in the State recognized that we even had a problem. We are redoubling those conservation efforts for 2001.

3. State Transmission Acquisition

NCPA supports the formation of a non-profit, public transmission entity – or Publico – to replace the California ISO and own and operate the transmission facilities within the state. The State is pursuing purchase of the private utilities' transmission facilities as a means of restoring the financial health of the companies and providing collateral to the state.

While a state purchase of the transmission assets of the IOUs can work, we have serious concerns with the framework of the proposed acquisition. We are working with the Governor and others to address the following issues:

- ✓ **Purchase Premium** – NCPA and its members depend on the transmission facilities of Pacific Gas and Electric, one of the State's three investor-owned utilities, to move power from our generation resources to our member communities. Paying 2.3 times the book value to acquire PG&E's transmission assets could raise our transmission rates significantly and make our consumers pay disproportionately for the financial rescue of PG&E. It is possible for the state to both purchase these assets at a premium, and avoid increasing costs associated with transmission, either through targeting the acquisition premium to IOU consumers or through other savings. There is a point, however, when the purchase price will outstrip the anticipated value. We hope that the purchase price stays within the range that does not require transmission price, or tax, increases to our consumers.
- ✓ **Interconnection Agreements** – NCPA and its members have interconnection agreements with PG&E that outline the terms and conditions of our transmission service. It is our expectation that any final agreement to purchase the IOU transmission system should respect and extend existing interconnection agreements.
- ✓ **System Upgrades/Repairs** – We believe the state should give full consideration to the upgrades and repairs necessary in the existing transmission systems of the IOUs. Any final negotiations over price should reflect those anticipated projects

and costs. The publicly owned electric systems of California, through TANC and SPPCA, have offered to assist in this endeavor.

✓ **ISO Reform** – We continue to work on reaching an agreement to participate in the Cal-ISO or some future, similar organization. To date, the complexity and costs associated with Cal-ISO membership prevent municipal utilities from joining. Reform of the Cal-ISO should be tied to a state purchase of the IOU transmission system.

We believe these issues can be adequately and fairly addressed, either through the purchase terms or through Federal Energy Regulatory Commission review of the asset disposition under Section 203 of the Federal Power Act.

Fair, open access to the transmission system is critical to our industry and consumers as a whole. NCPA believes that it is possible to use the IOU's financial situation to accomplish this public good. We agree that this opportunity should not be missed and that a reasonable framework can be designed to accomplish both goals.

4. Transmission Additions – Path 15

The transmission system within the State is woefully inadequate. We believe that the current system must be both upgraded and expanded. One critical component of this effort is Path 15 – the major link between northern and southern California.

Had the current Path 15 transmission constraint been eliminated, we could have avoided the rolling blackouts that Northern California experienced last June and this January. Relieving this constraint – building a third, 95-mile line between Los Banos and Gates – has been identified by the Cal ISO as the top transmission priority in the state.

Given the financial position of PG&E and the uncertainty about transmission ownership, alternative approaches are needed to fast-track this project.

Awareness of the need to solve the Path 15 problem has spread quickly in the last few months, and support for moving the project ahead has been voiced by Members of Congress, by the Bush Administration, by Governor Davis's Administration, by PG&E, and even by the California Public Utilities Commission. And yet, as this hearing is being held here today, a critical deadline for undertaking biological field tests is slipping past us. If those tests are not begun immediately, construction on Path 15 will be delayed by one year, since the tests must be conducted beginning in the early spring of the year.

NCPA and most of its members are, with SMUD and others, members of the Transmission Agency of Northern California (TANC), an agency created to enhance open access to adequate transmission capacity in the State. In recognition that work needed to be started immediately, TANC stepped forward this spring to begin that fieldwork. TANC committed $100,000 of its members' funding to begin the studies, notwithstanding the lack of any guarantee we would ever be compensated for that expenditure.

Effective April 9, we were prepared to begin the actual testing, having completed preliminary work including establishing the line for the project, receiving owner's permission to access property, etc. The next phase of work, however, will cost some $50,000 per day, or a total of $1 million. TANC has been seeking federal or state funding to cover those costs, with an understanding that all such costs would be recovered from operation of the completed transmission line. TANC members cannot assume the financial risks involved without any mechanism for recovering the costs.

Legislation has moved out of committee in the California Assembly that would provide funding for Path 15, but it seems unlikely to be passed in time to allow anyone to meet the spring deadline. We had received indications that the Governor was considering an emergency order to provide funding immediately, but the action taken two weeks ago by the CPUC in ordering PG&E to submit a Certificate of Public Convenience and Necessity Application based on their plans to build Path 15 and to begin this field work immediately apparently killed that initiative. In light of last Friday's bankruptcy announcement, it appears most unlikely that PG&E will be able to finance this project in time to begin the necessary field work this spring.

It is NCPA's belief that, given the current situation, the best and fastest way to move this project is to support the federal Western Area Power Administration (WAPA) as it exercises its role as the lead agency for the environmental assessment for the project. WAPA performed initial environmental and engineering work on the project. That experience and familiarity with Path 15 would expedite the process. Additionally, WAPA should be authorized to work on the design, engineering and land acquisition activities for this project. In addition, WAPA's ability to acquire rights-of-way could help to expedite the construction process.

It is not necessary for WAPA to either construct or own the line. A myriad of options are available. However, the line needs to be built, and WAPA is in a position to help start the process more quickly than any other entity.

At this time, we, cooperatively through TANC, are working with the State to secure support and financial assistance. However, we believe that federal support is also warranted and appropriate. The arrangements with TANC and WAPA, which were the last successful constructors of high-voltage transmission in the State, give the highest probability of success for this project.

Appropriate Federal Actions

I understand that the response of this Administration and many in Congress has been for California to get its house in order before looking for federal assistance. I believe the State is taking positive steps, however, I believe federal action is also needed.

In the short-term, NCPA supports the need for price stabilizing rates for the entire western wholesale power market. Consumers and the economy are bleeding, and we must apply a tourniquet. Imposing price stabilizing rates is neither a cure, nor a long-term solution. However, it is an appropriate step to provide interim relief until the long-term steps can be taken to support a competitive wholesale market. We are willing to work with all parties to design this interim measure in a manner that will maintain incentives for building new generation. I understand some have raised concerns about the treatment of non-jurisdictional utilities in any FERC-applied interim rate. I would urge you to consider the facts and not be distracted by any jurisdictional red herrings:

- ✓ Municipal utilities make a small share of total wholesale market sales in California – with the majority of our generation dedicated to serving native load;
- ✓ NCPA members are net purchasers on the wholesale market. We must attempt to recover our variable, fixed and opportunity costs when we make sales to offset the high prices we pay when we are purchasing. To do otherwise would be fiscally irresponsible.

- ✓ Many of our sales have been at the request of the Cal-ISO or PX to provide needed power – and these sales have reduced our ability to operate our plants to serve native load consumers this Summer;
- ✓ We were early and consistent supporters of interim price protections – and have pledged to voluntarily abide by any interim pricing structure.

Another near-term step that the federal government can take is to support the upgrades to Path 15 through clear authorization for WAPA to participate in this project as a partner, and by providing the initial funding that would be fully repaid by either the state, or the ultimate owner of the line.

I hope, however, that we look beyond short-term "band-aids" and take actions that address the underlying problems that plague the Western market.

The recent California experience has taught us a number of critical lessons:

- ❖ Without clear authority on RTOs, FERC accepted inadequate, inferior and flawed filings from the Cal-ISO. ***FERC needs clear authority and direction on RTOs to promote truly effective, regional and independent transmission management.***
- ❖ While California would be the 6th largest country in the world based on GDP, it is not big enough to serve as a stand-alone energy market. ***Markets are regional, and the transmission system must be run in a manner that supports interstate commerce.***
- ❖ There are numerous transmission constraints in California that have contributed to the rolling blackouts and locational market power. While the Cal-ISO identifies these constraints, it has no authority to take corrective action. ***Current transmission constraints – like Path 15 – must be eliminated. Ultimately, RTOs***

should have clear authority and responsibility to plan and expand the transmission grid. Federal transmission siting authority is also needed.

- Creation of contrived markets – within the PX and ISO – don't work and exacerbate market problems. ***While there is a need for institutions to ensure independent grid management, these institutions should have minimal market*** involvement.
- Markets do not work well when there are too few market participants and scarcity of supply. ***FERC must establish clear and effective rules to promote sustainable competitive markets prior to granting authority for market-based rates.***
- While there are conflicting accounts on whether generators have exercised market power, manipulated supply and bids, taken advantage of poorly designed market rules or simply profited from scarcity, it is clear that there is little public confidence in the current system. ***Reformatting FERC's role so that it is an effective market monitor, with clear authority and direction to detect and correct market manipulation or abuse, is needed.***

Congress and FERC have exclusive authority over interstate commerce in the sale of electricity. The interstate market is not currently working and will not sustain effective competition. It is critical that the structure and mechanisms necessary for a competitive market be established.

NCPA is a participant in the Electricity Stakeholders – a diverse coalition supporting wholesale market reforms – and urges the Committee to adopt legislation consistent with the Stakeholder principles.

Trinity River

NCPA supports, and has consistently supported, restoration of the fishery in the Trinity River. Work that has been done thus far has shown very favorable impact on the fishery, with catches running at record levels throughout the last year. We believe that the fishery can be restored without increasing flows to the extent called for by the Department of the Interior (DOI) in its EIS/EIR and Record of Decision on Trinity.

The "preferred alternative" favored in the EIS/R requires more water to be diverted to the Trinity River than is necessary to restore the fisheries. NCPA has worked closely with the Sacramento Municipal Utility District (SMUD) in developing alternative approaches. We support SMUD's statement at today's hearing. Real, workable alternatives have been offered that will lessen the impact on power customers while restoring the fisheries.

Recent reports show record runs of salmon and steelhead trout on the Klamath and Trinity Rivers. As of November 3, 2000, the numbers of salmon returning in both the spring and fall runs at the Trinity Dam near Lewiston were over twice as many as in all of 1999, demonstrating that fisheries *can* be restored without such dramatic increases in water in the Trinity. The EIS/R, however, completely ignored fish recovery data after 1992.

The impact of the Trinity River Preferred Alternative, combined with Central Valley Project Improvement Act (CVPIA) power impacts, could result in between 124 megawatts (MW) and 324 MW of lost peak generating capacity, enough power to serve some 324,000 households in California. Over the course of an average year, estimates for lost generation exceed 250 GWh, or $25 million. Wet year estimates exceed $50 million. California is in the midst of an electric energy supply crisis. The DOI decision therefore threatens California consumers. While DOI was still considering its decision, Senator Feinstein and eight California members of the House of Representatives requested Secretary of the Interior Bruce Babbitt to fully consider electric power generation and reliability impacts of the Trinity River Decision, but those requests were not adequately addressed in the final EIS/R

Further, diverting water away from the Central Valley Project (CVP) will have adverse environmental and fishery impacts on all rivers within the CVP, but those impacts were not adequately considered in the EIS/R.

NCPA seeks a balanced approach to the restoration of the fisheries in the Trinity River. Given California's current electricity supply crisis, any reasonable approach to restoration must allow adequate time for the crisis to be resolved. The "preferred alternative" does not provide balance and ignores this crisis. For these reasons, NCPA has joined with SMUD and others in seeking a judicial solution to the problems inherent in the EIS/EIR and the Record of Decision.

Conclusion

NCPA remains committed in its belief that a competitive market is beneficial to all consumers. However, such a market will not miraculously appear simply by declaring markets deregulated. As the California experience has demonstrated, deregulated markets that lack the structure to support effective competition will simply cause consumer and economic hardship.

California has begun to take steps that, if properly executed, can help resolve the current crisis. But Congress cannot simply pass the buck and watch the fall-out. Federal action must also occur. As a first-step, FERC must re-impose regulatory discipline in the uncompetitive western power markets. But we cannot stop there. Congress must also provide FERC with necessary guidance and authority to promote and monitor effective competition in the wholesale market.

NCPA looks forward to working with the Subcommittee in promoting both of these objectives.

LARGE SCALE BIOLOGY

April 6, 2001

The Honorable Doug Ose
U.S. House of Representatives
722-B Main St.
Woodland, CA 95695

Re: Field Hearing, Energy Reform

Dear Mr. Ose:

I sincerely regret that I am not able to attend in person on behalf of Large Scale Biology Corporation this important hearing regarding the current energy crisis in California. This is an issue we have a great deal of interest in, not only as a business located in Solano County, but as a member of the community of California. Large Scale Biology recognizes that there will not be a single solution that will solve the energy problem and that only as a team of nonpartisan Californians and Americans using all of our best ideas can we be effective at addressing both the short-term and long-term energy needs of this great state.

Last summer we attended a seminar on the state of electrical generation capacity for California presented by Pacific Gas & Electric (PG&E). The focus of the meeting was the inability of California to meet electrical demand during times of peak usage, and that this was projected to reach a critical stage within a year. This prediction has come true and there is no quick, permanent fix.

One important aspect of the PG&E presentation was that during periods of peak demand PG&E calls for a voluntary 20% reduction in consumption by their 1-megawatt and larger customers, for which these customers are able to participate in a program that provides an energy credit to them if they achieve the targeted measured reduction.

At the conclusion of that presentation, Large Scale Biology proposed an additional way to reduce power requirements during emergency demand situations in order to avoid blackouts. Although we are only a 1/2-megawatt customer, we are capable of removing 100% of our load from the grid by using our backup generator. During an electrical emergency, we could remove 500kva from the grid. This is more than twice the 200kva reduction achieved by a 20% reduction from a 1-megawatt customer. We believe that this is an important additional, unutilized source of electrical savings in California. Coincidentally, other companies approached PG&E after the seminar with the same proposal as we had. One of them was Pacific Bell, who has over 200 emergency generator facilities in northern California alone. Our suggestion inspired our PG&E representative to discuss this idea with his corporate headquarters in San Francisco.

The Honorable Doug Ose
April 6, 2001
Page 2

While we waited for a decision from PG&E, Californians experienced their first day of rolling blackouts in the Bay Area due to extreme demand caused by a heat wave. Like other concerned businesses, we were able to voluntarily curtail some usage by turning off unnecessary lights, but in reality it did little to impact the real problem. Afterwards, the PG&E representative called and reported that PG&E had previously considered a similar approach to the one we had suggested but had abandoned the idea due to opposition from the California Air Resources Board (CARB). CARB was concerned that emergency diesel backup generators could increase overall air emissions thereby creating an air quality problem.

We believe that the current energy crisis constitutes a statewide emergency and that it is in the best interest of California that a temporary suspension of the regulations prohibiting the use of diesel backup generators be immediately granted by the responsible State and Federal agencies. Such action will permit those businesses that can help to do so. As part of this program, PG&E must extend their current reimbursement program to include businesses that generate their own power when asked by PG&E. This can easily be done with available demand meters capable of measuring usage in small increments of time, thus allowing PG&E to measure and then credit businesses for the electricity produced.

I hope these comments and suggestions are a useful contribution as a meaningful part of a short-term solution to the energy crisis facing us all. Large Scale Biology is committed to doing its part to help solve this serious problem.

Sincerely,

LARGE SCALE BIOLOGY CORPORATION

David R. McGee, Ph.D.
Chief Operating Officer

DRM/kh

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Hoopa Valley Tribal Council

HOOPA VALLEY TRIBE

Regular Meetings on the First and Third Thursday of Each Month

P.O. Box 1348 • HOOPA, CALIFORNIA 95546 • Phone 625-4211 • Fax 625-4594

Duane J. Sherman, Sr.
Chairman

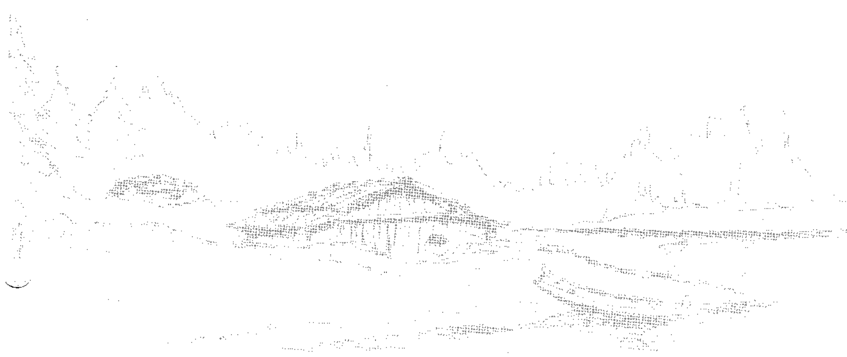
Caroline Katzin
House Committee on Government Reform
2157 Rayburn Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Ms. Katzin April 11, 2001

The Hoopa Valley Tribe attempted, in advance, unsuccessfully, to be placed on the list for oral testimony for yesterday's public hearing in Sacramento organized by Congressman Ose's subcommittee on Energy Policy, Natural Resources, and Regulatory Affairs yesterday. Attached is written testimony I would like submitted for the Congressional record to be associated with that public hearing. I would be grateful if you would place the attached testimony in the official record and advise our legal counsel, Joseph Membrino, (202) 973-1219, as to the outcome of my request.

Sincerely,

Duane J. Sherman, Sr., Chairman
Hoopa Valley Tribe



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Duane J. Sherman, Sr.
Chairman

**TESTIMONY OF THE HONORABLE DUANE SHERMAN, SR.,
CHAIRMAN OF THE HOOPA VALLEY TRIBE,
BEFORE THE COMMITTEE ON GOVERNMENT REFORM**

Re: "Assessing the California Crisis: How Did We Get to This Point, and Where Do We Go From Here?"

**TUESDAY, APRIL 10, 2001 11 a.m. PST
Sacramento, Convention Center
1400 J Street - Room 204
Sacramento, California**

Mr. Chairman, and members of the Committee, thank you for the opportunity to submit this testimony. I am Duane Sherman, Sr., Chairman of the Hoopa Valley Tribe. On December 19, 2000, I welcomed the Secretary of the Interior, representatives of our congressional and state delegations, officials of Trinity and Humboldt Counties, tribal leaders from around the state, and representatives of the Trinity River Task Force to Hoopa-- to "Natinook" "where the trails return". We gathered there to witness the adoption of the Trinity River Restoration plan that we believe will lead to the rebirth of the Trinity River. The plan is based on 20 years of scientific research and public involvement in which our Tribe played a leading role.

The Trinity River restoration plan combines physical restoration actions, monitoring, and increases in water supply to meet federal trust responsibilities to protect Indian fishery resources and to achieve the goal established by Congress to restore degraded fish populations (some species of which are listed under the Endangered Species Act) to levels that existed prior to construction of the Trinity River dams that began in 1955.

The Hoopa Valley Tribe has vested, reserved property rights in the Trinity River fishery that have been reaffirmed by Congress, the judiciary and the executive branch. For 500 generations the Hupa have lived along the Trinity River in the Hoopa Valley. The river and its fishery are part of the fabric of our culture and religion, and the source of our sustenance. Yet, for the last two generations the Hupa have known a different river.

When the Trinity River Division of the Central Valley Project was completed, the river the Hupa people had known for thousands of years was transformed in less than a decade. Gone was its broad channel with well-washed gravels for spawning. Gone were its pools, shallows, and shade for juvenile rearing. Gone were the velocity, volume, and frequency of flows essential to fish migration. Today most Trinity River fish populations are either listed, proposed for listing, or under status review for listing under the Endangered Species Act. Each Hupa has a personal story of what the damage to the fishery has meant to our families and communities.

The Trinity River restoration plan conforms with Congress' 1955 mandate that restoration and maintenance of the Trinity River basin's fish and wildlife resources take precedence over diversions of water to the Central Valley. Congress established that unique basin-of-origin protection for the Trinity River in order to prevent any harm to a region of California that would realize no benefit from the export of its water to the Central Valley. (The Trinity River is the only source of water imported by the Central Valley Project.)

The area of origin priority for Trinity River basin needs has been exercised in this case with fairness and generosity. The Trinity River restoration plan provides for the continued annual average export of 52% of the Trinity River's flow at Lewiston, California, into the Central Valley for irrigation, hydro power and municipal uses. The balance (48%) will be released to the Trinity River and used to restore and maintain fish and wildlife resources on which the economically depressed Trinity and Humboldt counties depend. The restoration plan enables the diversion of such a generous portion of the Trinity River water supply to be developed for Central Valley uses because of the intensive management, monitoring, and mechanical restoration activities that have been included in the plan. Those measures require federal funding without which diversions of water to the Central Valley will be jeopardized and the health of the fishery further degraded.

We are persuaded that the Department of the Interior's decision to adopt the restoration plan is sound, balanced, and fair to all who depend on the Trinity River. It completes a process supported by the Carter, Reagan, Bush and Clinton Administrations. Unfortunately, some Central Valley interests have filed suit to enjoin implementation of the restoration plan. The Department of Justice and the Department of the Interior have mounted a vigorous defense of the restoration plan in which the Hoopa Valley Tribe has intervened as a defendant.

On March 22, the federal court in Fresno ruled that the Department of the Interior's decision "must move forward, because the law (C[entral] V[alley] P[roject] I[mprovement] A[ct] mandates, and all parties admit that the Trinity River must be restored. The court lacks the legal authority and the inclination to substitute its judgment for that of the Secretary." Westlands Water District v. U.S. Department of the Interior, CIV F 00-7124 OWW DLB (E.D. Calif., filed March 22, 2001) (Memorandum Decision and Order Re: Motions For Preliminary Injunction at 54). The Court also observed the urgency of the Trinity River's condition, stating that "the statutory mandate to restore the Trinity River" is five years overdue. (Id. at 22).

Accordingly, the Court ordered that the water supply for the Trinity River fishery be increased from the current 340,000 acre feet (the third-lowest unregulated flow on record (over 80 years) in the Trinity River" id. at 6) by approximately 29,000 acre-feet.(Id. at 55). That amount represents the fishery water supply called for in the Department's decision in a critically dry year. The Trinity River Basins is in a critically dry condition this year. In addition, the Court ordered that "all other aspects of the R[ecord] O[f] D[ecision] regarding river restoration may proceed." (Id.)

The court, did however, conclude that a supplemental environmental impact statement (SEIS) was necessary to analyze: (1) the effects of two biological opinions that had been issued with the Final Environmental Impact Statement; and (2) "the effect of implementation of the preferred alternative in light of the changed circumstances of California's current energy crisis." (Id. at 53).

The court did not take further action against the Department's decision because it recognized that the decision was made "to protect the environment by increasing River flows to enhance the salmonid habitat and satisf[y] the five-year overdue statutory mandate to restore the Trinity River." (Id. at 22). The court added that the "presumption for granting injunctions when NEPA violations purportedly exist, does not apply in the `unusual' circumstances where `enjoining government action allegedly in violation of NEPA might actually jeopardize natural resources.'" (Id. at 21). The court thus perceived the irony in the plaintiffs' attempt to use environmental laws to delay or disable restoration and protection of the Trinity River environment.

The Hoopa Valley Tribe has recommended to the Secretary of the Interior that she proceed promptly to prepare the SEIS. Nonetheless, the Tribe is confident that the Trinity River Final Environmental Impact Statement has already taken a hard look at the effects of the Department's decision on California's energy supplies. Further, the Tribe is confident that restoring the Trinity River neither caused nor will contribute to the energy crisis in California. The Committee must recognize that during the development and escalation of the energy crisis not a single drop of water was allocated to the Trinity River in excess of the amount determined by President Bush's administration in 1991.

We have worked seriously and cooperatively to restore our river. Any fair-minded person can see this. To answer the questions in the title of this hearing: The Trinity River restoration decision did nothing to bring the California energy crisis to its current state. Nor is there any change that could be made to that decision to help resolve the crisis. There simply is no basis on which to associate the energy crisis with protection of the Trinity River's environment. More than one-half of the Trinity's water is still to be diverted to the Central Valley for water and power purposes. It is time for the fighting and second guessing to stop. Let the Trinity River live and with it the hopes and dreams of not only our people but the thousands of Trinity basin residents and commercial fishermen who depend on the Trinity River.

Berliner
Candon
Jimison

Washington, Los Angeles,
Berkeley, and Sacramento
A Professional Corporation

April 25, 2001

Subcommittee on Energy Policy,
Natural Resources, and Regulatory Affairs
Committee on Government Reform
U.S. House of Representatives
B-377 Rayburn House Office Building
Washington, D.C. 20515

Dear Sirs:

Pursuant to conversations between Richard Brent, Government Affairs Director for Solar Turbines Incorporated, and Mr. Dan Skopec of the Subcommittee Staff, I am pleased to enclose the Testimony of Solar Turbines for submission in the record of the hearings held by the Subcommittee on the California electricity crisis. I was informed that a single copy of the testimony was sufficient. Please call me if there are any questions or problems with this submission.

Sincerely,

John W. Jimison, Esq.

Attorney for
Solar Turbines Incorporated

John W. Jimison
Attorney at Law
1225 19th Street, NW, Suite 800
Washington, DC 20036-2453 USA
Telephone 202.955.6067 ext 308
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TESTIMONY OF
RICHARD S. BRENT
DIRECTOR, GOVERNMENT AFFAIRS
SOLAR TURBINES INCORPORATED

BEFORE THE
SUBCOMMITTEE ON ENERGY POLICY, NATURAL RESOURCES AND REGULATORY AFFAIRS

COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

IN HEARINGS ON
ELECTRIC UTILITY INDUSTRY RESTRUCTURING: THE CALIFORNIA MARKET

Introduction

Solar Turbines is a leading manufacturer of combustion gas turbine generator sets. Of the 11,000 Solar combustion gas turbines installed around the world, over 4,000 generator packages are sited in the United States. Solar Turbines is currently working in partnership with the United States Department of Energy to develop high efficiency, low emissions, low cost advanced turbine systems (ATS) specifically designed for distributed power generation. Solar Turbines is owned by Caterpillar Inc., the world leader in the manufacture of earthmoving and mining equipment. Caterpillar also makes reciprocating engines, often used for power generation. Together, Caterpillar Inc. and Solar Turbines are one of the largest manufacturers of electrical generation capacity in the world, producing each year about twenty gigawatts of generating plant – the equivalent of nine Hoover Dams.

We are pleased to submit our testimony for the record of the Subcommittee as it reviews the electricity crisis in California. Consumers and businesses in this state have been involuntary participants in what has effectively been a massive initial experiment in electric industry reform, and the costs to them have been extreme. Solar Turbines urges this Subcommittee, the rest of the Federal government, and the California state government to work closely and quickly to alleviate the huge economic penalty that has effectively been imposed on this State and the broader western region.

In this testimony, Solar Turbines will provide its own perspective on the general problems, but we will not attempt to compete with the elaborate analysis of causes and effects the Subcommittee will have heard from other witnesses. Instead, our testimony will focus on the company's role as a part of the solution through its business of providing equipment for high-efficiency, low-emission distributed generation of electricity. I will note the barriers that have so far prevented greater application of distributed generating resources and the policy changes needed to remove those barriers.

The Nature of the Problem

As the electricity industry is a highly complex group of enterprises and activities, so too the current problems are highly complex. The essence of the current problem, stated as simply as I can, is that there is a persistent mismatch between the new market structure designed and embodied in State legislation and the actual market dynamics of the electricity business. The mismatch has proved outside the capability, if not the jurisdiction, of the Federal Energy Regulatory Commission to overcome through its own decisions. And there remains a fundamental dispute over the extent to which the market mechanism ***can*** operate to determine supply, demand, and prices for electric power.

There has been a general consensus that in the electricity industry, as in other industries that were once thoroughly regulated, it makes sense to allow the competitive forces of the free market to work their magic in providing price signals to consumers and suppliers to the extent possible, gaining economic efficiency as a result. Yet the same consensus holds that many electricity industry activities, such as transmission, distribution, facility siting, and environmental emissions, must remain subject to regulation in the public interest – these are not activities that can be simply deregulated.

Determining how to restructure once-pervasive regulation to allow market forces to operate where they can operate is not an easy task. Solar believes that it would have been unreasonable to expect that electric industry restructuring could have proceeded without any "glitches." By their nature, markets are unpredictable. Newly created markets are particularly unpredictable. For this reason, Solar Turbines is unwilling to join in attempting to assign blame to anyone for the problems that have been experienced. The key questions are what should be changed to make the new structure work better and how should the impacts of the problems to date be alleviated.

A major part of the problem has come from the fact that the markets have moved on while the complex decision-making process of restructuring was unfolding. Yet the uncertainties about the new structure of regulations and market incentives kept those who would earlier have responded to market developments by adding capacity and transmission from doing so. Key market changes included the following:

- Electricity demand has reportedly grown strongly, driven by resurgent economic growth in California following several low-growth years in the early 1990s.
- Peak summer weather conditions have added seasonal emphasis to this demand growth, as has very low precipitation to provide hydroelectric power.
- New capacity investment awaited clarity in the new institutional roles of the utilities and other market participants. It is simply not feasible to make multi-million-dollar commitments of resources to a new generation plant if one is uncertain about the terms under which that plant can be operated, or even whether that plant must be sold to others.
- Similarly, new transmission investment was not made, leading to the perpetuation and growth of transmission bottlenecks. Transmission bottlenecks isolated and amplified generation capacity shortages.
- On the demand side of the market, very few consumers have the flexibility or timely information to be able to react to market price signals by adapting their usage, creating an artificially inelastic short-term demand curve.

While regulators were focused on reshaping the fundamental regulatory structure of the electric industry, there was not similar focus on the underlying siting, permitting, and environmental regulations applying to electricity facilities. Compartmentalized regulatory regimes over siting, environmental emissions, and other public policy purposes pursued their own agendas without awareness of the growing urgency to add generating capacity. As a result, once the signals began to emerge from a newly competitive electricity market, the potential participants were unable to respond in a timely manner. They continued to be subject to the welter of inflexible, time-consuming, multi-agency regulations and requirements that not only delayed new generation, but added significantly to its costs and to the uncertainty of cost recovery that creates business risk. In a market, higher business risk means a higher minimum price threshold. It is not merely hunger for profits, but also knowledge of the risks from continued uncertainty that leads market participants to seek maximum returns when returns are available. In short, regulatory speed and flexibility have not matched the market's speedy evolution or new requirements.

There has also been a failure to recognize that the very mechanics of the electricity industry have also been changing as a function of new technology. In particular, new small-scale electric generation technologies have in recent years created the potential for a proliferation of generators sited near load centers. These small power sources include not only the turbines manufactured by Solar Turbines, but other technologies that are emerging.

Restructuring policy-makers have been slow to recognize that the new regulatory structure needed not only to accommodate competitive electricity markets, but also to accommodate the new potential for distributed generation. In the same way that the old monopoly electrical utility industry paradigm (generating, transmitting, distributing, and selling all by the same company) is being restructured, Solar Turbines believes that the old paradigm of large remote power plants, long-distance high voltage transmission, and networks of distribution wires will also undergo dramatic reconfiguration. The emerging electricity industry will be much more a network of both suppliers and consumers, linked together for optimum reliability and uniformity by a grid of distribution and transmission wires, and joined in a transparent, broad, and seamless market for electricity supply pricing. So far, the regulatory restructuring has been too much designed for the old industry, not the new one.

How can distributed generation help solve the problems?

Distributed generation, i.e., generation sited in numerous places on the grid, and particularly near load centers, offers solutions to numerous issues confronting us today. In the face of generating capacity shortages, distributed generation offers multi-faceted help:

- Assembly-line production of medium sized distributed generation units allows for rapid response to orders, and therefore promises – depending on regulatory and permitting delays – exceptionally short lead-times to achieving new capacity on line. A typical turn-key combined heat and power installation for continuous operation can be completed in one year. A peaking unit can be ready to meet periodic requirements typically in about nine months.

- Distributed generators are sized precisely to the need they are intended to fill. Because they are linked to the demand conditions of a particular user or area, demands which are therefore more easily projected, there is no risk of over-investment which has in the past created problems for electric rates and utility company financial health.

- Distributed generation customers can obtain total certainty of the capital costs of their generating equipment, allowing them valuable economic predictability and autonomy. While they may still be subject to fuel price uncertainty, today's fuel markets allow hedging in futures and other derivative transactions in a manner that can also make fuel prices predictable. Distributed generators can thus protect themselves significantly from the variability of the broader market.

- Perhaps more important to the questions confronting this hearing, distributed generators can help dampen the market-price swings that may otherwise occur in the broader market: when prices are high, they can self-generate and take demand out of the surging market, perhaps also selling additional power into that market.

In addition to the benefits of adding new capacity to the market, distributed generation offers the important additional benefit of reducing the burdens on the transmission and distribution system. Sited at load centers, distributed generators require less of the limited capacity of transmission lines and distribution lines bringing power from remote central generating stations. Indeed, they may export power into the grid. Environmental and aesthetic impacts, land use issues, and land-owner resistance has made it virtually impossible to add new transmission right-of-way throughout the United States. Increasing the voltage of existing transmission lines presents major technical, investment, and timing issues. Distributed generation can be a major part of the answer to this dilemma by adding generation at the consumer's end of the line, and thereby improving both the transmission access and the transmission reliability of all users who continue to use system transmission and distribution resources.

In addition, distributed generation can mitigate residual concerns about generating-industry market power by creating a large number of new and dispersed generators on the supply side of the bulk power markets, increasing competition, and adding capacity available to purchasers on behalf of small customers.

While these benefits of distributed generation clearly help the restructured electricity market directly, society as a whole benefits from the general energy efficiency gains and environmental emission reductions that come from creating combined heat and power applications. Simple-cycle thermal generation efficiency still averages about 30% -- the balance of the energy content of the fuel is lost though waste heat discharge. Delivery to consumers may take an additional 10% of the original energy in the form of line losses on transmission and distribution lines. By contrast, local combined heat and power applications can usefully extract upwards of 90% of the original fuel energy –

from two to three times the overall energy efficiency. This energy efficiency helps put downward pressure on fuel market prices.

Equally important to the efficiency gain, combined heat and power creates air emissions that are one-half to one-third of what they would be from accomplishing the same purposes with separate fuel consumption. While some emissions must come from any combustion-powered generator, a combined heat and power application is one of the lowest-emission technologies available. These environmental benefits are shared with everyone, and can help offset the increased emissions that would otherwise come from continued economic growth.

Economically and environmentally, distributed power generation therefore makes good sense. The current process of restructuring the electric industry is a tremendous opportunity for regulators and policy-makers to reduce the serious barriers that are preventing distributed generation and combined heat and power from playing their appropriate roles in the electricity market.

Obstacles to achieving the promise of distributed generation.

There are numerous barriers to the implementation of distributed generation, including but not limited to the following:

- **Lack of standardization of requirements.** Distributed generation units are manufactured to be standard in their inputs and outputs, yet there has not been a parallel standardization of treatment by regulators, environmental permit authorities, and utilities. Much red tape could be cut and substantial time saved in getting the needed electricity to the consumer by adopting standardized regulatory and permitting requirements to apply to standardized units.
- **Lack of accepted interconnection policies.** Interconnection standards in particular often differ from utility to utility, and can be unduly complex and burdensome. Intentionally or not, such complexity discourages competition with the utility's own generation. There are no major technical issues with interconnection of distributed

generation in a manner that is fully compatible with reliable grid operation. This is done all over the world. At present a nationwide standard for interconnection is being completed by the IEEE. California has moved toward uniform interconnection standards. Solar Turbines hopes that this movement will quickly gain acceptance by all so that interconnection will no longer be a barrier to distributed generation. However, Solar Turbines also supports the interconnection language in such bills before Congress as H.R. 1045, sponsored by Congresswoman Heather Wilson.

- **Rate policies that discriminate against self-generation.** Utility rates are frequently set in a manner that discourages distributed generation in order to preserve industrial load for the utilities, under the assumption that other ratepayers would suffer cost increases if industrial load went to self-generation. In fact, as noted above, all customers obtain significant system benefits when distributed generation is installed, not merely the company installing it.

1 For example, distributed generators effectively create additional transmission and distribution capacity by removing their own load from the total demand and often by providing excess energy to other users downstream of transmission bottlenecks. Yet rate policies typically deny distributed generators any credit for this effect of their operations. Indeed, rate regimes typically burden distributed generators by attributing to their new generation a full share of the cost of transmission and distribution systems they will not use as a result of the new generation, as if their new distributed generation were adding to rather than subtracting from the load on the system.

2 Sometimes industrial customers are offered special discounts in utility rates to encourage them not to install their own generation. When industrial rates are discounted to prevent a customer from opting for distributed generation, all customers may be the losers, because the other customers rates must offset the discount and all customers lose the efficiency and environmental benefits.

3 Frequently distributed generators are charged high rates for standby and peaking power they may require from the grid as a disincentive to self-generate. On the contrary, distributed generators should be credited in their rates for the contribution their generation makes to system reliability at the margin and for the diminished transmission constraints as a result of their self-generation.

These ratemaking policies are vestiges of an earlier regulatory environment premised on utility monopoly power and non-market economics for consumers and generators alike. Utilities are no longer required to provide non-market price subsidies to alternative power suppliers, and utilities should not be permitted to discriminate against them. Customers will only seek to install distributed generation where it makes economic sense to them, and do not require utility subsidies to do so, but should not face artificial economic barriers from outmoded rate policies. At the same time, regulators should identify ratemaking approaches for transmission and distribution which do not premise the utility's cost recovery on a given volume of electrical throughput, which creates disincentives on the utility's part to encourage on-site power generation.

- **Ambivalence about the utility role in distributed generation.** Many utilities themselves are aware of and support the need for distributed generation, yet until their own potential role in building and operating distributed generation is clarified, they are often resistant to having other parties construct such generation on their systems. Solar Turbines believes that except in states where regulators have forbidden utilities to own generation, the utilities themselves or their affiliates should be able to own and operate distributed generation units to meet the supply needs they continue to serve, such as core loads. There is no reason that the utilities themselves should not be able to capture the economic, efficiency, and environmental benefits of distribute generation. However, the terms for others to add distributed generation to the utility grids must be no different or more onerous than the terms the utilities themselves must meet. In other words, an open market means open competition!

- **Defining distributed generators as utilities.** Under current state and federal policies (particularly the Public Utility Holding Company Act ["PUHCA"]), distributed generators may be subject to traditional regulation as public utilities in order to make any off-site sales. In the new electricity industry, "wires" companies are the utilities; those who generate and sell power, especially at wholesale or to bulk power markets and exchanges, are competitive entities that clearly do not require regulation. As in other unregulated sectors of the economy, their fully-enforceable contractual duties, obligations, and rights eliminate any need for utility-style regulation.

What the Federal Government should do

Solar Turbines believes that the electricity industry is inherently a regional industry, not a state or national industry. There is no level of government which ideally fits a regional industrial structure for purposes of regulation and approvals. It is understandable that State authorities want to continue regulation of industry functions they have traditionally managed, and this is appropriate for regulation of distribution rates, interrelationships of suppliers and utilities with consumers, facility siting, and other inherently local activities. However, much of the efficiency that can be achieved in electricity restructuring will come from moving toward larger workable markets for power, and reducing barriers to those markets. Indeed, markets already are operating regionally (and indeed internationally in the case of the region California is part of) and must therefore operate under federal supervision.

Transmission capacity generally must interconnect and serve the entire regional market, and therefore should generally also function under federal supervision. Solar Turbines believes that transmission regulation should aim to achieve viable electricity commodity markets which are not bounded at state borders but which are open, nondiscriminatory, and transparent at the regional and inter-regional level.

Solar Turbines does not attempt in this testimony to prescribe a new state-federal division of responsibility for a restructured industry, merely to indicate that there are critical roles for both levels of government, and both must cooperate to get the legal structure right so that the markets can function optimally. Solar Turbines will be happy to work with Subcommittee members and staff to refine these ideas and express them in appropriate legislation.

The key issue is timing. Solar Turbines is concerned that after several additional years of attempting regulation fundamentally at the state level, Congress will eventually be compelled to step in to assure the minimum consistency of policy in certain key areas to preserve functional regional markets. This should happen sooner rather than later.

Among other things, both the federal and state governments should work to reduce the barriers to distributed generation mentioned above. In particular:

- Congress should consider actions that will identify uniform national standards for interconnection of distributed generation and require all utilities involved in interstate commerce in electricity to adopt such standards.
- Congress should encourage the states to change rate policies to encourage distributed generation, and combined heat and power generation, and to eliminate rate policies that penalize self-generators.
- FERC should be empowered to adopt nondiscriminatory rate policies throughout wholesale and interstate markets that recognize the system benefits of distributed generation, and that liberally allow distributed generators to interconnect to the grid under a common set of interconnection standards. Utilities that utilize the grid for their own wholesale bulk power transactions should be expected and required to offer ready interconnection of distributed generators to the grid for wholesale transactions.
- Where generation ownership by utilities is not prohibited by state law, utilities and their affiliates should be permitted to own and operate distributed generation resources on the same basis and under the same constraints that they own and operate any other form of generation.

- Congress should repeal the provisions of PUHCA that would require regulation of distributed generators making off-site sales, and should either clarify or encourage the states to clarify that distributed generators can sell power without becoming public utilities subject to regulation under the provisions that apply to monopoly electric distribution and transmission companies.

What the federal and state governments should **not** do is panic in the face of current difficulties. They should certainly cooperate on quick actions to ease the economic trauma in this area, and should work to prevent similar short-term market crunches in other areas by learning the lessons of California. Market-driven electric commodity markets are working in other parts of the country and the world, and can work in California and throughout the regions of the United States. The difficulty is structuring them to allow the proper pricing signals to flow both to the suppliers and consumers, and reforming the regulatory structure so that both suppliers and consumers can react to those signals quickly. Transmission and distribution regulation must support the viability of the commodity markets for power, and create proper incentives for transmission and distribution investment, in order to avoid balkanizing and hamstringing the commodity markets.

Conclusion

Distributed generation can offer, as noted above, very important assistance in reaching many of the public policy goals that electricity restructuring must not ignore: the need for growing, efficient, dispersed, and diversified new supply capacity, with a net benefit to transmission and distribution resources, all at a net benefit to environmental emissions and general fuel-use efficiency. Because a large part of the answers to the current dilemmas with electricity restructuring can and should come from distributed generation, a large emphasis in electricity restructuring policy should be put on removing barriers to distributed generation, including those cited here.

It is Solar Turbines' business objective to play a major role in the development of distributed generation and combined heat and power projects in support of the goals and objectives of a restructured utility model. But it is also Solar Turbines' responsibility to its community to assist with creating an electric market structure that is efficient, economic, and fair to all consumers in the ways that only an competitive market can achieve.

TO ~~MARK SEETIN~~

BUSINESS DIGEST

Saturday, June 10, 2000
San Francisco Chronicle
CHRONICLE SECTIONS

FAIR ISAAC PLANNING TO GIVE INDIVIDUALS CREDIT-SCORE ACCESS

Bowing to pressure from consumer groups and some legislators, San Rafael's Fair Isaac and Co. said it will make credit scores available to individuals, but it didn't say how, when or whether it will charge.

Fair Isaac sells mathematical formulas for gauging risk based on a consumer's credit history, but it does not keep credit information. That information is compiled by the nation's three large credit bureaus. To obtain credit scores, Fair Isaac will have to get the credit information from the credit bureaus. It has only begun negotiating for that information.

In the meantime, it has disclosed for the first time a clear and comprehensive list of the factors used to devise risk scores. The factors can be found at www.fairisaac.com, and the score explanation service is expected to be live next month. PUC PRESIDENT BLASTS DECISION: California's three investor-owned utilities shouldn't be allowed to purchase power on open markets because prices are volatile and could be passed on to consumers, the state's top utility regulator said. State regulators voted 3 to 2 Thursday to allow utilities to buy electricity from sources other than the California Power Exchange, a state-regulated electricity market. "I'm deeply concerned that the (state Public Utilities Commission) made a wrong turn," said Loretta Lynch, president of the state PUC. Lynch voted against letting utilities bypass the power exchange. Consumers could wind up with higher electricity bills if utilities are able to buy power from wherever they want, she said.

TO ~~MARK SEETIN~~
Dan + Caroline

To ~~MARK SEETIN~~ Dan Skopec & Caroline Katzin

AT&T TO REVISE RATE INCREASES: AT&T

Corp., the largest U.S. long-distance telephone

Regional Roundup

[18] CPUC Vote on CalPX Buy Rule Could Be Undone by Legislators *(from [2])*

A few days after the California Public Utilities Commission's three Republican members voted to end the California Power Exchange mandatory-buy requirement, a state budget subcommittee slipped a proposal into the California spending plan that would negate the CPUC decision.

The move was led by Senator Jim Brulte (R-Cucamonga) and Assemblymember Jim Runner (R-Lancaster), with the backing of Senator Steve Peace (D-El Cajon), according to capital insiders. It is a slap in the face to commissioners Joe Neeper, Richard Bilas and Henry Duque, who voted to undo the requisite buy rule (see CEM No. 570 [13]).

The bipartisan budget subcommittee voted 6-0 last Tuesday night to make the CPUC's vote unenforceable because the legislators believe that allowing the state's three large investor-owned utilities to buy power outside the CalPX is contrary to the intent of AB 1890, the restructuring legislation authored by Peace and Brulte.

Ed Cazalet, CEO of the Santa Clara–based Automated Power Exchange, which would reap the benefits of multiple exchanges, disagreed with the state legislators. "The PUC created the buy mandate, not the Legislature," he said. The legislators "voted to move towards a more competitive environment and achieved that" *[Elizabeth McCarthy]*.

[18.1] Bills Addressing Environmental Justice and Irrigation District's Distribution Expansions Overhauled

A bill that would protect against power plants being sited predominantly in low-income and minority communities had its teeth removed before being heard by the Assembly Utility and Commerce Committee last Monday. "There is little left of the bill, it couldn't be much weaker," lamented Sierra Club legislative advocate Bill Magavern.

SB 1622, by Richard Alarcon (D-Van Nuys), would have required the California Energy Commission to adopt regulations by January 1, 2002, to ensure that CEC plant certification decisions conform to federal guidance on environmental justice. According to Alarcon, his legislation would have formalized the CEC's recognition of the need to incorporate environmental justice issues into the siting process. The commission has not taken a formal position on the bill (see CEM No. 564 [14.3]).

The proposed regulations under SB 1622, however, were removed at the behest of the Independent Energy Producers, the California Manufacturers & Technology Association and the Western States Petroleum Producers.

Committee chair Rod Wright (D-Los Angeles) also urged at the committee hearing that the regulation provision be taken out of the bill because federal guidance on environmental justice has not been finalized. He was concerned that state rules to avoid plants being placed in communities of color and poor neighborhoods would impede power-plant development.

"Environmental justice recognizes that we have to bear our fair share of obnoxious facilities, and the need to spread out that burden," Alarcon replied. He warned that if new power plants fail to meet federal civil rights standards, they could face lawsuits.

The new language for SB 1622 would require only that the CEC develop an environmental justice mission statement in consultation with the Governor's Office of Planning and Research by July 1, 2001.

During the committee hearing, the amended language was not clear, and the bill's opponents wanted to make sure all their proposed changes were incorporated. Wright agreed to postpone a vote on the legislation for a week. After the hearing, Magavern said Wright "won't accept anything that is not blessed by all the energy companies."

> There is little left of the bill, it couldn't be much weaker.

Another bill that was substantially changed while winding its way through the legislative process is AB 2638, which would have essentially prohibited irrigation districts from competing in the distribution market. The bill by Thomas Calderon (D-Montibello) took aim primarily at Modesto, Merced and Turlock irrigation districts, which have been busy expanding their electrical customer bases in and outside their territory, much to the consternation of Pacific Gas & Electric (see CEM No. 567 [18]).

The language of the bill was stripped and replaced with "placeholder" language, which will allow the legislation to go forward. In the meantime, negotiations on the bill's language are taking place between PG&E, the irrigation districts and the Agriculture Energy Consumers Association, which opposed the bill, according to Michael Boccadero, AECA lobbyist.

The overhauled AB 2638 will attempt to resolve a number of touchy electric distribution competition issues, including stranded distribution and transmission costs, cost shifting between investor-owned utility shareholders and ratepayers, universal service requirements, criteria providing distribution and transmission services and condemnation power of irrigation districts.

The bill is scheduled to be heard in the Senate Energy Utilities and Commerce Committee's June 27 hearing *[E. McC.]*.

ASSESSING THE CALIFORNIA ENERGY CRISIS: HOW DID WE GET TO THIS POINT, AND WHERE DO WE GO FROM HERE?

WEDNESDAY, APRIL 11, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
San Jose, CA.

The committee met, pursuant to notice, at 9:44 a.m., in the Loma Prieta Ballroom, San Jose State University, One Washington Square, San Jose, CA, Hon. Dan Burton (chairman of the committee) presiding.

Present: Representatives Burton, Horn, Ose, Lofgren, Lee and Honda.

Staff present: Kevin Binger, staff director; Caroline Katzen, professional staff member; Robert Briggs, chief clerk; and Elizabeth Mundinger, minority professional staff member.

Mr. BURTON. Seeing a quorum the committee will come to order.

I ask unanimous consent that all Members' and witnesses' written opening statements be included in the record, and without objection so ordered.

I ask unanimous consent that all articles, exhibits and extraneous or tabular material referred to be included in the record, and without objection so ordered.

I ask unanimous consent that Members of Congress who are not members of the committee be allowed to participate in today's hearing, and without objection so ordered.

I ask unanimous consent that all questions submitted in writing to the witnesses and their answers be included in the record.

I ask unanimous consent that questioning in this matter proceed under clause 2(j)(2) of House rule 11 and committee rule 14 in which the chairman and ranking minority member allocate time to members of the committee as they deem appropriate for extended questioning, not to exceed 60 minutes equally divided between the majority and minority. Without objection so ordered. We will however try to stay to the 5-minute rule early on so that we can accommodate Mr. Hebert, but we will go around as many times as we need to go around.

I want to welcome everyone to our second day of hearings on the energy crisis here in California. I am going to keep my opening statement fairly brief because our first witness, Mr. Hebert, is under some time constraints and even more time constraints since we are running a little late, and I want to have as much time as possible for the Members to ask questions.

I want to say a couple of things about yesterday's hearing in Sacramento. We came out here because there is a problem. We want to understand it, we want to be a part of the solution. We did not come to point fingers; we came here to listen and to learn. We wanted to see if there were ways the Federal Government and the State government could work together to get past and through this crisis.

We want to play a constructive role. This summer, Congress is going to have a serious debate about our country's energy policies. If there are ways we can help, we want to do that. But first, we need to understand the problems. We are trying to take a balanced look at all sides of this equation. Today, we are going to hear from the chairman of the Federal Energy Regulatory Commission, Mr. Hebert. We are going to hear from the utilities. Tomorrow, we are going to question the energy producers. I think we are going to have a well-rounded debate.

What is becoming clear to me is that when you boil it all down, the root problem here is supply and demand. One of our witnesses yesterday was an independent energy analyst. He told us that over the last 5 years, California's economy has grown by about 32 percent, but at the same time, energy generation in the State actually fell. So you had a tremendous increase in demand and supply was not keeping pace.

A new power plant has not been completed in this State in the last 12 years—I think that is accurate.

The head of the ISO told us yesterday that he expects to have a 3,000 megawatt-hour shortage during peak periods this summer and that is very serious. Everyone agrees that more generating capacity is needed, but that is going to take some time. The question is, how do we manage the situation in the meantime.

Some people say price caps are the answer. We will not have any demonstrations here today because we want to get through this. So if people want to demonstrate, I suggest you do it out outside. If we have to, we will have the police remove you. I am going to keep order in this meeting. So if you want to hear what is going on, be patient and listen because we are going to hear all sides.

Some people say price caps are the answer. They want the FERC to impose price caps. My concern is that price caps for California may cause power to be diverted to other States where sellers can get better prices. Three out of our four energy experts who testified yesterday said that if FERC reimposed price caps tomorrow, it would lead to more blackouts this summer. In fact, the head of the ISO, Mr. Winter, testified that he made an emergency request to FERC last December to relax the price caps to avoid a collapse in the system. So I do not think the price caps are a panacea. But we are going to continue that discussion today with Mr. Hebert from FERC.

We also had a long discussion yesterday about long-term contracts. The major utilities have said that they tried to enter into long-term contracts last summer. They said that they could have locked in a long-term rate of 5 cents a kilowatt hour. That would have saved billions of dollars. But they said that red tape at the Public Utilities Commission stopped it from happening.

Ms. Lynch said that the Commission did not stand in their way, but I got the impression that we were only getting one side of the story. Today, we will ask California Edison and PG&E what happened from their perspective.

This is no small issue. The general counsel from FERC talked about long-term contracts yesterday. He said that if San Diego Gas and Electric had entered into a long-term contract a year ago, they would have saved roughly $5 billion last year. So I think it is worth taking some time to get to the bottom of this.

We are going to hear from two alternative energy producers. Most of these facilities across the State had to shut down because they were not being paid. This contributed directly to blackouts this spring. If they do not begin receiving payments soon, this will make the electricity shortage this summer even worse.

We also have a number of other issues to discuss. PG&E has declared bankruptcy. Cal Edison has agreed this week to sell their transmission grid to the State to get out of debt. We want to discuss those issues and others.

At this point, I want to stop my opening statement so we can get on with the questioning and I want to thank our witnesses for being here, and I look forward to your testimony. And if other Members have opening statements, I will yield to them. Ms. Lofgren, do you have an opening statement?

[The prepared statement of Hon. Dan Burton follows:]

Opening Statement
Chairman Dan Burton
Committee on Government Reform
"Assessing The California Energy Crisis:
How Did We Get To This Point, and Where Do We Go From Here?"
San Jose, California
April 11, 2001

Good morning. I want to welcome everyone to our second day of hearings on the energy crisis here in California. I'm going to keep my opening statement fairly brief. Our first witness, Mr. Hebert, is under some time constraints this morning, and I want to have as much time as possible for questions.

I do want to say a couple of things about why we're here. We came out here because there is a problem. We want to understand it, and we want to be part of the solution. We didn't come to point fingers. We came to listen and learn. We wanted to see if there were ways the Federal government and the State government could work together to get past this crisis.

We want to play a constructive role in this crisis. This summer, Congress is going to have a serious debate about our country's energy policies. If there are ways we can help, we want to do that. But first, we need to understand the problems. We're trying to take a balanced look at all sides of this equation. Today, we're going to hear from the Chairman of the Federal Energy Regulatory Commission. We're going to hear from the utilities. Tomorrow, we're going to question the energy producers. I think we're going to have a well-rounded debate.

What's becoming clear to me is that, when you boil it all down, the root problem here is supply and demand:

- One of our witnesses yesterday was an independent energy analyst. He told us that over the last five years, California's economy has grown by about 32%. But at the same time, energy generation in the State actually fell.

- A major new power plant hasn't been completed in this state in the last twelve years.

- The head of the ISO told us yesterday that he expects to have a 3,000 megawatt-hour shortage during peak periods this summer – that's pretty serious.

Everyone agrees that more generating capacity is needed. But that's going to take time. The question is, how do we manage the situation in the meantime.

Some people say price caps are the answer. They want the FERC to impose price caps. My concern is that price caps for California may cause power to be diverted to other states where sellers can get better prices. Three out of our four energy experts who testified yesterday said that if FERC reimposed price caps tomorrow, it would lead to more blackouts this summer. In fact, the head of the ISO, Mr. Winter, testified that he made an emergency request to FERC last December to relax the price caps to avoid a collapse of the system. So I don't think that price caps are a panacea. But we're going to continue that discussion today with Mr. Hebert from FERC.

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We also have a number of other issues to discuss. PG&E has declared bankruptcy. Cal Edison has agreed this week to sell their transmission grid to the state to get out of debt. We want to discuss those issues and others.

At this point, I want to stop my opening statement so we can get to the questioning. I want to thank our witnesses for being here. I look forward to your testimony.

STATEMENT OF HON. ZOE LOFGREN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. LOFGREN. First, Mr. Chairman, I have a statement I will submit for the record, but I would like to thank the chairman for allowing me to participate in this hearing even though I am not a member of the committee and welcome you to the 16th Congressional District.

Mr. BURTON. You have a beautiful city.

Ms. Lee.

[The prepared statement of Hon. Zoe Lofgren follows:]

Opening Statement
Rep. Zoe Lofgren
"Assessing the California Energy Crisis"
House Committee on Government Reform
San Jose, California
April 11, 2001

Good Morning. Mr. Chairman, I want to thank you for the opportunity to participate in today's hearing. It was very courteous of you to invite me to join the panel even though I am not a Member of the Committee on Government Reform.

Our State of California is experiencing an electricity crisis that has resulted in blackouts throughout the state, inconvenienced our citizens and played havoc with the state and region's economy. The crisis may or may not inflict permanent damage to our economy and has national implications.

Our electricity rates have already soared. We expect more of the same. Last year, we paid $7 billion for electricity – this year California ratepayers are projected to pay as much as $70 billion. Last week, PG&E filed for Chapter 11 bankruptcy, and more uncertainty clouds the short-term and long-term energy horizon.

To date, the current Administration has not launched a credible response to California's energy problems. I hope FERC Commissioner Hebert can convince President Bush to become more involved.

Though the Federal Regulatory Energy Commission has jurisdiction over wholesale energy rates, FERC has advocated a "hands-off" policy when it comes to capping wholesale rates. Many Members of Congress disagree and we have introduced legislation to cap rates temporarily while assuring generators a "reasonable" return.

While FERC has ordered some refunds based on "price-gouging" by generators, much greater refunds are due. The ISO has estimated the cost of overcharges between May 2000 and February 2001 amounted to $6.3 billion.

FERC has failed to address market manipulations and check runaway wholesale rates. I urge the Administration to get off the sidelines and to come to California's aid.

Mr. Chairman, thank you again for inviting me to this hearing. I look forward to listening to our panelists.

STATEMENT OF HON. BARBARA LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. LEE. Thank you, Mr. Chairman, I too want to thank you for allowing me to participate in today's hearing and I want to thank our witnesses for coming today to discuss this crucial issue. I would like to submit my statement for the record.

This crisis is not a Democratic crisis, nor is it a Republican crisis; it is a crisis that affects all consumers and it is going to require bipartisan solutions.

And thank you again for conducting this hearing.

Mr. BURTON. We agree with that, and thank you for your statement.

Mr. Ose.

[The prepared statement of Hon. Barbara Lee follows:]

Congresswoman Barbara Lee
Government Reform Committee
April 12, 2001
Assessing the California Energy Crisis: How Did We Get to this Point and Where Do We Go from Here?

Statement:

I want to thank the chair and members of the Government Reform Committee for allowing me to participate in today's hearing and thank our witnesses for coming today to discuss this crucial issue. Energy powers our economy as well as our lives. Today we face a crisis.

President Bush has indicated essentially that California's energy problems are its own concern. However, modern energy systems by their nature and design cross state borders. Oregon, Washington, and Arizona are already directly caught up in this so-called California issue, and supply problems have emerged in New England and are expected in New York and elsewhere in the country. It is clear that energy cannot be treated as just another free market commodity.

Costs have skyrocketed; demand has not. FERC has declared that prices have been unjust and unreasonable. We need to take action today to protect consumers, encourage conservation and innovation, develop renewable resources, and regain control of the energy markets. We need whole-sale based price controls. We need to increase not cut our national investment in renewable energy and energy efficiency, contrary to the budget the President submitted this week. We need to increase LIHEAP funding to help low income Americans pay their bills for this basic necessity; in the President's budget, LIHEAP was frozen. Finally, we need a national energy policy that includes short-term corrections to out of control prices and long-term solutions to our reliance on fossil fuels.

Mr. OSE. I do want to explore this article in the LA Times this morning about the alleged price gouging from the municipalities, so I am hoping some people can provide feedback on that.

I will submit my statement for the record.

Mr. BURTON. Thank you.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. I will waive the right of an opening statement so we can get down to questions and answers.

Mr. BURTON. Mr. Representative Honda.

STATEMENT OF HON. MICHAEL HONDA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. HONDA. Thank you, Mr. Chairman. I just want to welcome you to San Jose and thank you for holding the committee hearing.

I will submit my questions and my statements in writing also, but I just wanted to reiterate some of the positions that many of our colleagues have taken, Mr. Chairman, that we are looking for not only long-term solutions, but short-term; and I think one of my concerns is a short-term solution that we have talked a lot about and that is the temporary capping of prices and with a deadline, sunset, on that.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Michael Honda follows:]

Government Reform Committee Field Hearing
Congressman Mike Honda
Talking Points
April 11, 2001

Thank you Chairman Burton for holding these important hearings and inviting me to participate. I welcome this opportunity to once again reaffirm my position that FERC must get off the sidelines and act! And Chairman Hebert, thank you for appearing before the Committee here on the frontlines of the California energy crisis. I'm hoping that today you can explain why the federal government refuses to act within its authority and hold energy suppliers accountable for price gouging.

Most recently, I joined with Democratic members from California, Oregon and Washington in cosponsoring legislation that would direct FERC to impose cost-of-service based rates to protect consumers in the Western states. This legislation would also allow states to recover past and present "unjust and unreasonable" overcharges from generators—an option that is currently unavailable to the States despite the egregious behavior of energy generators. So far we have been unable to compel FERC and the Bush Administration to assert their authority and their obligation to ensure that energy prices are just and reasonable.

The economic undercurrents of the electricity problem reach into virtually every aspect of our lives. The effect can be felt in our schools that must now divert funds away from buying books or hiring additional teachers in order to pay their energy bills. The effect can be felt in our communities where emergency services may no longer be sufficiently available and the effect can be felt in our Silicon Valley businesses that have already lost tens of millions of dollars during the last few months.

<u>**Questions**</u>

1. Chairman Hebert, I'm sure my position is not new to you. I've written to you in the past to express my displeasure with FERC's inaction. Of the three-person commission, you've been the most vocal and staunch opponent to instituting any kind of price controls. You've argued that the market is the most effective means to stabilize the energy prices. I certainly respect your opinion, but my primary concern lies with my constituents and with the residents of California—residents who have seen an extraordinary increase in energy prices. In 1999, California consumers paid $7 billion for energy. In 2000, they paid $27 billion and this year, consumers can expect to pay more than $50 billion. This past March, the California Independent System Operator concluded that **market power abuses** may have cost consumers as much as $6.3 billion. These costs are draining the resources of local governments, businesses, schools and households.

In November and December, FERC concluded, in Commissioner Massey's words, that the dysfunctional market in California is not producing just and reasonable prices. My question, Chairman Hebert, is under what conditions—if any—would you support **some** form of price controls?

2. Chairman Hebert, you indicated in your March testimony before the House Energy Subcommittee that price caps are not a long-term solution. I agree with you. I don't support unnecessarily government regulation, especially when the markets can more effectively reduce the prices of critical services. But my immediate concern is with the short-term!

   You've argued that cost-of-service rates will blunt a price signal that will encourage consumers to conserve and spur new generation. However consumers in CA will see their rates rise this summer and there are strong incentives to conserve--particularly with the threat of blackouts. Still, little new generation will be able to come online this summer. We are going to have a shortfall of 5,000 to 6,800 Mw this summer no matter what. Charging $1,400 or more per Mw will not change this fact and everyone knows it. Under current supply and demand conditions, there will be no limit to what generators will charge unless there is federal intervention. Without federal intervention, consumers will be punished for a crisis they had little role in creating.

   I've seen no proposals by FERC or the Administration that will add more generation to the market this summer. My question, therefore, is how can the market signal possibly provide relief to California ratepayers in the short-term?

3. The State of California and Southern California Edison on Monday reached an agreement by which the State would purchase Edison's transmission lines. As I understand it, FERC needs to approve this deal. Can you explain the process by which FERC will evaluate this purchase and what immediate concerns you have about the State's ownership of Edison's transmission lines?

4. Mr. Chairman can you explain for me why gas prices in California are significantly higher than gas prices elsewhere in the country? There are reports that some pipeline operators may be gaming the market. Can you tell me what FERC is doing to explore these allegations?

Mr. BURTON. Thank you, Congressman.

Mr. Hebert, would you please rise?

[Witness sworn.]

Mr. BURTON. Do you have an opening statement, sir?

Mr. HEBERT. Yes, I do, Mr. Chairman.

Mr. BURTON. Proceed.

STATEMENT OF CURT HEBERT, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

Mr. HEBERT. Thank you. And let me introduce, before I start, our general counsel, to my left, to your right, sir, Kevin Madden, who I believe testified before you yesterday.

Mr. BURTON. Welcome, Mr. Madden again.

Mr. MADDEN. Thank you, Mr. Chairman.

Mr. HEBERT. Thank you for the opportunity to appear here today to discuss the topic of electricity markets in California and surrounding States.

Electricity markets in California and through much of the West are in a State of turmoil and they will continue to experience very serious problems throughout this coming summer. Wholesale prices have increased substantially, consumers are being implored to conserve as much as possible, and utilities continue to face severe financial problems. Last Friday's announcement of Pacific Gas & Electric Co., that it has filed a reorganization under Chapter 11 of the U.S. Bankruptcy Code represents only the latest and the most obvious example of this turmoil.

The Federal Energy Regulatory Commission has aggressively identified and implemented market-driven solutions to problems by stabilizing wholesale energy markets; by identifying additional short-term and long-term measures that will increase supply and delivery infrastructure, as well as decrease demand; by promoting the development of a west-wide regional transmission organization, understanding that we have a natural market that works in the West; and by monitoring market prices and market conditions.

Let me highlight just some of the recent actions we have taken to address these problems. Early last month, the Commission took action to mitigate prices in California's electricity markets in January and February of this year. The Commission identified many transactions during these 2 months that warranted further investigation. The Commission required the sellers to either refund certain amounts, or offset these amounts against amounts owed to them, or provide additional justification for their prices. The total amount of potential refunds for these 2 months is $124 million.

Also in March, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and the West. The Commission implemented certain measures immediately, including encouraging sales of backup or onsite generation and sales of demand reductions; extending and broadening waivers for certain facilities under the Public Utility Regulatory Policies Act of 1978, enabling those facilities to generate more electricity; expediting certifications of natural gas pipelines into California and the West; and for example, Mr. Chairman and members of the committee, we issued one just the other day, the Kern River Project.

We got that filing out in 3 weeks, something absolutely unheard of at the Federal Government and specifically at the FERC.

Urging all licensees as well to review the FERC-licensed hydroelectric projects in order to assess the potential for increasing generating capacity.

The Commission also proposed and sought comment on other measures such as incentive rates for new transmission facilities and natural gas pipe facilities completed by specific dates.

And finally, the Commission announced a 1-day conference with State commissioners and other State representatives from Western States to discuss price volatility in the West as well as other FERC-related issues, related and identified by the Governors of the Western States. That conference was held yesterday in Boise, ID.

On March 14, the Commission ordered two utilities to justify the duration of outages at their California generating facilities. The outages forced the California ISO to purchase more expensive power from the utilities' other generating facilities. Absent adequate justification, the utilities must make refunds, again, of over $10 million.

On March 28, the Commission addressed a complaint by the California Public Utilities Commission against a pipeline company and its marketing affiliate. While the FERC found one part of the complaint unsupported, the FERC ordered a hearing on whether the pipeline and its affiliate had market power, and if so, used it to drive up natural gas prices at the California border. The case is now pending before an Administrative Law Judge.

These actions and many others I have not discussed, Mr. Chairman, demonstrate the Commission's commitment to take all appropriate actions to remedy the current imbalances in the Western energy markets.

While some have accused the Commission of being indifferent or hostile to the concerns of California consumers, our actions prove otherwise. We have pursued the remedies we believe will be most effective, not only in the short term, but also in the long term. No one should doubt the Commission's commitment to ensuring an adequate supply of energy for all consumers, at reasonable prices. By itself, the Commission can contribute only a small part of the solution to today's energy problems. A more comprehensive and permanent solution requires the involvement of the States and other Federal agencies and departments.

As long as we keep moving toward competitive and regional markets, I am confident that the present energy problems, while serious, can be resolved.

Mr. Chairman and members of the committee, I thank you for your hard work and I thank you for helping us shed light on this subject.

[The prepared statement of Mr. Hebert follows:]

Summary of Testimony of
Curt L. Hébert, Jr., Chairman
Kevin P. Madden, General Counsel
Federal Energy Regulatory Commission
Before the Committee on Government Reform
United States House of Representatives
April 10-12, 2001

Wholesale and retail electricity markets in California and throughout much of the West are in a state of stress, and they will continue to experience very serious problems throughout the coming summer. Wholesale prices have increased substantially for a variety of reasons, consumers are being implored to conserve as much as possible, and utilities continue to face severe financial problems. Pacific Gas & Electric Company has now filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. As a result of California's market dysfunctions and their impact in the West, many now argue that we need to return to cost-based regulation, instead of relying on market-driven solutions.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices send the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices below market levels through regulation or legislation will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Federal Energy Regulatory Commission has been aggressively identifying and implementing market-driven solutions to the problems: (1) by stabilizing wholesale energy markets; (2) by adopting or proposing additional short-term and long-term measures that will increase supply and delivery infrastructure, as well as decrease demand; (3) by promoting the development of a West-wide regional transmission organization; and, (4) by monitoring market prices and market conditions.

Other regions that have not adopted California-type restrictions on electricity competition have demonstrated that consumers can and do gain from electricity competition and restructuring. California and Western consumers similarly can share in these gains, once market rules are in place that will make California and other Western states an attractive place for investment.

Testimony of
Curt L. Hébert, Jr., Chairman
Kevin P. Madden, General Counsel
Federal Energy Regulatory Commission
Before the Committee on Government Reform
United States House of Representatives
April 10-12, 2001

I. Overview

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear here today to discuss the topic of electricity markets in California. As we all convene here today, we are keenly aware that wholesale and retail electricity markets in California and throughout much of the West are in a state of stress and that these markets will continue to experience very serious problems throughout the coming summer. Wholesale prices for electricity have increased substantially for a variety of reasons in the last year. California power consumers are being implored to conserve. California load-serving utilities continue to face severe financial problems, and one of those utilities, Pacific Gas & Electric Company, has filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. And companies supplying wholesale power into California are unsure how much, or even whether, they will be paid for their supplies.

While the situation in California is not representative of other parts of the country that are successfully developing competitive markets, it nevertheless underscores the fundamental infrastructure problems facing the country. The demand for electricity continues to expand while supply fails to keep pace. The development and licensing of new hydroelectric capacity – which provides much of the existing power supply in the West – is nearly exhausted. Very little fossil-fired generation has been added in many regions of the country over the last few years, and in California no major plants have been added in the last decade. And the existing electric transmission grid is often fully loaded and, absent necessary expansion, is often incapable of delivering power to those regions where it is valued the most.

I would like to make three main points with respect to these problems and to identify the steps the Commission is taking to address these problems.

First, price caps are not a long-term solution. We need to promote new supply and load reductions. Market prices send the right signals to both sellers and buyers (at least those not subject to a rate freeze). Market prices will increase supply and reduce demand, thus correcting the current imbalance. Capping prices below market levels will have exactly the opposite effect.

Second, infrastructure improvements are greatly needed throughout the West and especially in California. We need to create the appropriate financial incentives to ensure that new generation is built, that the transmission system is upgraded and that new gas pipelines are built.

Finally, we need a regional transmission organization (RTO) for the West. California is not an island. It depends on generation from outside the State. The shortages and the prices in California have affected the supply and prices in the rest of the West. The Western transmission system is an integrated grid, and buyers and sellers need non-discriminatory access to all transmission facilities in the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

Consistent with these three points, the Commission continues aggressively to identify and implement solutions to the problems:

- **First**, in recent months, the Commission has issued a number of orders intended to restore market stability. The Commission has acted to move utilities out of volatile spot markets to enable them to develop a portfolio of risk reducing and creditworthy contracts that will reduce price risks.

- **Second**, the Commission has recently adopted or proposed a range of additional measures that will increase supply and delivery infrastructure, as well as reduce demand for electricity in the Western Interconnection.

- **Third**, the Commission is continuing to work with market participants on developing, as quickly as possible, a West-wide regional transmission organization. Such an organization will bring a regional perspective and offer regional solutions to regional problems.

- **Fourth**, the Commission is monitoring market prices and market conditions with the goal of ensuring long-term confidence in Western markets. Moreover, the Commission's staff has proposed a new plan to monitor and, when appropriate, mitigate the price of electric energy sold in California's spot markets on a before-the-fact basis, instead of addressing prices through after-the-fact refunds. The Commission expects to act on this proposal by May 1, 2001.

By itself, however, the Commission can contribute only a small part of the solution to today's energy problems. A more comprehensive and permanent solution requires the involvement of the states and other federal agencies and departments. I am encouraged by all of the hard work and effort undertaken in recent months by the State of California and other Western states. The issues are difficult and the stakes are high. While reasonable minds can differ over the appropriate solutions to these problems, the Commission is committed to resolving these problems deliberatively.

An attachment to my testimony provides details on the Commission's actions concerning California's electricity markets in recent months.

II. What Went Wrong Here?

A. Legislative Design

The State of California has been widely questioned for its restructuring legislation (AB 1890), unanimously enacted in 1996. While mistakes were made, California is to be commended for realizing that consumers are better off if supply and pricing decisions are based on market mechanisms, not bureaucratic fiat. The premise of this legislation was that consumers would enjoy lower rates and increased service options, without compromising reliability of service, if electricity providers could be motivated to serve by market forces and competitive opportunities.

The major features of AB 1890 included: (1) creation of an independent system operator (ISO) and power exchange (PX) by January 1998 and simultaneous authorization of retail competition; (2) creation of the California Electricity Oversight Board with members appointed by the Governor and legislature; (3) a competitive transition charge for the recovery of the traditional utilities' stranded costs; and (4) a ten percent rate reduction for residential and small customers, and a rate freeze for all retail customers.

There were two major flaws in California's market design. First, the three utilities were forced to buy and sell power exclusively through the spot markets of the PX. This prevented the utilities from hedging their risks by developing a portfolio of short-term and long-term energy products. Second, the State-mandated retail rate reduction and freeze eliminated any incentives for demand reduction, discouraged entry by competitors for retail sales and, more recently, has threatened the financial health of the three investor-owned, load serving utilities by delaying or denying their recovery of billions of dollars in costs incurred to provide service to retail customers.

However, California's situation does not demonstrate the failure of electricity competition. To the contrary, it demonstrates the need to embrace competition fully, instead of tentatively. Other states, such as Pennsylvania, have been successful in implementing electricity competition. California needs to move forward on the competitive path it has chosen, allow new generation and transmission to be sited and built, and allow its citizens to benefit from the lower rates, higher reliability, and wider variety of service options that a truly competitive marketplace can provide.

B. Other Factors

Until last year, California's spot market prices were substantially lower than even California's mandated rate freeze level. This allowed the California investor-owned utilities to pay down billions of dollars of costs incurred during cost-of-service regulation. However, several events resulted in higher spot electricity prices beginning last summer. Those events included one of the hottest summers and driest years in history, as well as several years of unexpectedly strong load growth. Other factors that have recently influenced prices include:

- o unusually cold temperatures in early winter in the West and Northwest;
- o California generation was unavailable to supply normal winter exports to the Northwest;
- o very little generation was added in the West, particularly in California, Washington and Oregon, during the last decade;
- o environmental restrictions limited the full use of power resources in the region;
- o scheduled and unscheduled outages, particularly at old and inefficient generating units, removed large amounts of capacity from service; and
- o natural gas prices increased significantly, due to higher commodity prices, increased gas demand, low storage, and constraints on the delivery system.

Taken together, these factors demonstrate that the present problems in electricity markets are not just "California" problems. Normal export and import patterns throughout the West have been disrupted. Reserve margins throughout the West are shrinking. This winter, when the demand for electricity was relatively low, Stage Three emergencies in California were commonplace.

III. The Commission's Role in California's Restructuring

A. Start-up and Early Problems

The Commission began addressing the California restructuring in 1996. Initially, the Commission's approach was largely deferential to State decisions affecting wholesale power market matters within FERC's jurisdiction. However, as problems started surfacing and then heightened significantly in the Summer of 2000, the Commission found that it could no longer defer to State decisions affecting matters within the Commission's jurisdiction.

The resources devoted by the Commission to California's restructuring were significant from the beginning and, in recent months, have increased substantially.

In 1996 and 1997, the Commission approved, with limited exceptions, the jurisdictional aspects of the California restructuring as proposed. The Commission authorized the transfer of operational control of transmission facilities from Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SoCal Ed), and San Diego Gas and Electric Company (SDG&E) (collectively, the California IOUs) to the ISO. The Commission also authorized the ISO and PX to commence operations.

Shortly after the ISO and PX commenced operations on March 31, 1998, prices for ancillary services (e.g., spinning reserves) in the ISO's markets increased significantly. The ISO proposed purchase price caps as a solution. In response, the Commission authorized the ISO for an interim period to reject bids in excess of whatever prices the ISO believed were appropriate for the ancillary services it procured. The Commission stated, however, that a purchase price cap is not an ideal approach to operating a market and that it did not expect the cap to remain in place on a long-term basis. The Commission later approved an ISO filing seeking authorization for a similar purchase price cap for an additional ISO-operated market (imbalance energy).

Subsequently, the Commission authorized the ISO to continue specifying purchase price caps for ancillary services and imbalance energy until November 15, 1999. The Commission said the ISO could file for another extension of its price cap authority if serious market design flaws still existed. In late 1999, the ISO filed to extend the purchase price cap. The Commission permitted a purchase price cap of $250 to remain in effect from August 7 until December 8, 2001. (Buyer caps of $750, then $500, had been in effect prior to that time.)

B. Actions Taken Last Year

Last summer, bulk power prices in California began increasing significantly. (Other parts of the country also experienced price spikes then, but outside of the West prices generally subsided later in the year.) As the problems in California's bulk power markets mounted, the Commission realized that its policy of deference had not worked as intended, and that the Commission needed to take more of a leadership role in addressing the problems.

On July 26, 2000, the Commission ordered a staff fact-finding investigation on technical or operational factors, regulatory prohibitions or rules (Federal or State), market or behavioral rules, or other factors affecting the competitive pricing of electric energy or the reliability of service in electric bulk power markets. The Commission directed its staff to report its findings to the Commission by November 1, 2000.

In August 2000, the Commission issued an order initiating a formal hearing under Section 206 of the Federal Power Act (FPA) on the rates of public utilities that sell in California's spot markets. This action meant that refunds could be ordered as of the earliest possible refund effective date under Section 206 -- October 2, 2000 -- if rates were found to be unjust and unreasonable. The Commission on its own motion also ordered an investigation into whether the tariffs and institutional structures and bylaws of the California ISO and PX were adversely affecting the efficient operation of competitive wholesale electric power markets in California and needed to be modified.

On November 1, 2000, upon completion of the Commission staff study of bulk power markets, the Commission found that:

> the electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy (Day-Ahead, Day-of, Ancillary Services and real-time energy sales) under certain conditions.

93 FERC ¶ 61,121 at 61,349-50 (2000). To fulfill its duty under the FPA, the Commission then proposed a number of remedies "to establish market rules, regulations and practices that will ensure just and reasonable rates in the future." Id., at 61,350. The Commission allowed an opportunity for public comment on its proposed remedies, and held a technical conference with affected parties, including California state officials.

In an order issued on December 15, 2000, the Commission adopted a series of remedial measures designed to stabilize wholesale electricity markets in California and to correct wholesale market dysfunctions. The Commission recognized that the primary flaw in the California market design was the requirement for the California IOUs to buy and sell solely in spot markets. The Commission removed this requirement from the wholesale tariff to allow the utilities, first, to use their own remaining generation resources to meet demands at state-regulated prices and, second, to help them meet much of their remaining needs for power through forward contract purchases. Our action returned to California the ability to regulate about one-half of the California IOUs' peak load requirements. The Commission also ordered the termination of the PX's wholesale rate schedules effective as of April 30, 2001.

In addition, the order addressed the problem of underscheduling, directing utilities to arrange 95 percent of their transactions before real-time, to reduce the reliance on the ISO's real-time market. A penalty would be imposed for utilities that did not comply.

The order also established a $150 per MWh breakpoint mechanism as part of a rate monitoring and mitigation plan from January 1, 2001 until May 1, 2001, when the Commission expects to put in place long-term measures. The ISO's rules were modified so that bids above $150 per MWh would not set the market clearing prices paid to all bidders. Public utility sellers (primarily the investor-owned utilities) that bid above this breakpoint were required to file weekly transaction reports with the Commission. Sellers were made liable for refunds if the Commission finds they sold power at prices that were not just and reasonable.

C. The Commission's Latest Efforts

Since the Commission's change in Chairmanship on January 22 of this year, the Commission has implemented a number of significant steps to address the problems in the California and Western energy markets, as summarized briefly below. (Many of the following matters are still pending before the Commission, so my remarks are limited to describing the actions taken without further addressing the merits.)

On January 29, 2001, the Commission issued an order finding the PX in violation of its December 15 order by not implementing the $150 per MWh breakpoint mechanism, and it required immediate recalculation of wholesale rates by the PX. The Commission stated that the PX's violation was costing electricity consumers substantial amounts of money. The Commission cited an estimate by PG&E that the cost of the PX's violation for just one day in early January was over $20 million.

On February 14, 2001, the Commission addressed tariff revisions proposed by the ISO and PX to lower their creditworthiness requirements. At the time, the credit ratings of PG&E and SoCal Ed had deteriorated significantly, making them unable to meet the existing requirements. The Commission accepted the ISO's amendment to the extent of allowing PG&E and SoCal Edison to continue using their own generating resources to serve their own load. The Commission held, however, that the utilities could continue buying through the ISO from third-party suppliers only if they obtained adequate financial backing from others (such as the California Department of Water Resources). The Commission found this result necessary to prevent price increases to consumers because suppliers would otherwise raise their prices to compensate for the utilities' credit risk. (The Commission noted that the PX had suspended operations of its spot markets and, thus, rejected the PX's filing.)

On March 9 and 16, 2001, the Commission took further steps to mitigate prices in California, specifically the prices charged in California's spot markets during Stage Three emergencies in January and February of this year. After examining prices charged in these periods, the Commission identified many transactions that warranted further investigation. The Commission required these sellers to either refund certain amounts (or offset these amounts against amounts owed to them) or provide additional information justifying their prices. Specifically, the Commission required refunds or offsets of approximately $124 million. The Commission used a proxy price approach based on the market clearing price that would have occurred had the sellers bid their variable costs into a competitive single price auction.

On March 14, 2001, the Commission issued an order seeking to increase energy supplies and reduce energy demand in California and the West. The Commission implemented certain measures immediately, including: streamlining filing and notice requirements for various types of wholesale electric sales (including sales of backup or on-site generation and sales of demand reductions); extending (through December 31, 2001) and broadening regulatory waivers for qualifying facilities under the Public Utility Regulatory Policies Act of 1978, enabling those facilities to generate more electricity; expediting the certification of natural gas pipeline projects into California and the West; and, urging all licensees to review their FERC-licensed hydroelectric projects in order to assess the potential for increased generating capacity.

The Commission also proposed, and sought comment on, other measures such as incentive rates and accelerated depreciation for new transmission facilities and natural gas pipeline facilities completed by specified dates, blanket certificates authorizing construction of certain types of natural gas facilities, and allowing greater operating flexibility at hydroelectric projects to increase generation while protecting environmental resources. Finally, the Commission stated its intent to hold a one-day conference with state commissioners and other state representatives from Western states to discuss price volatility in the West, as well other FERC-related issues recently identified by the Governors of Western States. The conference is being held in Boise, Idaho, on April 10.

Also on March 14, the Commission ordered two utilities to justify the duration of outages at their California generating facilities. The outages forced the ISO to purchase more expensive power from the utilities' other generating facilities. Absent adequate justification, the utilities must make refunds.

On March 28, 2001, the Commission addressed a complaint by the California Public Utilities Commission under section 5 of the Natural Gas Act against El Paso Natural Gas Company and its marketing affiliate. The California Commission asserted that certain contracts between the pipeline and its affiliate for firm pipeline capacity to California raised issues of possible affiliate abuse and anti-competitive impact on the delivered price of gas and the wholesale electric market in California. FERC found the allegations of affiliate abuse unjustified. However, the Commission ordered a hearing before an administrative law judge on whether El Paso and/or its marketing affiliate may have had market power and, if so, exercised it so as to drive up natural gas prices at the California border. The Commission directed the judge to provide the Commission with an initial decision within 60 days.

In sum, the foregoing efforts demonstrate the Commission's commitment to take all appropriate actions to remedy the current imbalances in Western energy markets. While some have accused the Commission of being indifferent or even hostile to the concerns of California consumers, the Commission's actions prove otherwise. We have pursued the remedies we believe will be most effective, not only in the short-term but also in the long-term. Others may disagree with our solutions, but no one should doubt the Commission's resolve to ensuring an adequate supply of energy for all consumers at reasonable prices.

IV. We Need A West-wide RTO

The development of a West-wide regional transmission organization (RTO) is vital to preventing future problems in the West. The shortages and prices in California have affected the supply and prices in states throughout the West because the Western transmission system is an integrated grid. A West-wide RTO is critical to support a stable interstate electricity market that will provide buyers and sellers the needed non-discriminatory access to all transmission facilities in the West. A West-wide RTO will increase market efficiency and trading opportunities for buyers and sellers throughout the West.

A West-wide RTO should be truly West-wide. It should include participation by both public utilities as well as non-public utility entities such as municipalities and cooperatives. To encourage the formation of a West-wide RTO, Congress may wish to consider the elimination of tax or other restrictions on public power and cooperative participation in RTOs. Congress may also wish to consider eliminating any impediments to participation by the Bonneville Power and Western Area Power Administrations in a West-wide RTO.

V. Possible Sale of Transmission Assets to the State of California

One step that has been considered as a way to address the financial problems of California's public utilities is for the State to purchase their transmission facilities. Such a transaction, in my view, would require the Commission's approval. Section 203 of the Federal Power Act requires Commission review of the transfer of ownership or operational control of jurisdictional transmission facilities owned by public utilities, when such facilities have a value exceeding $50,000. If this transaction occurs, the Commission would need to decide whether the transaction is consistent with the public interest, based on all relevant considerations.

VI. Price Caps Would Make Things Worse

Some advocate price caps or cost-based limitations as a temporary way to protect consumers until longer-term remedies alleviate the supply/demand imbalance. The issue of price caps in the West has been raised on rehearing of the Commission's order of

December 15, 2000, and, accordingly, is pending before the Commission. For this reason, I cannot debate the specific merits of price caps for California or the West. However, I will reiterate briefly publicly stated views on this issue.

As a general matter, price caps do not promote long-term consumer welfare. Price caps will not increase energy supply and deliverability or decrease demand. Instead, price caps will deter supply and discourage conservation. At this critical time, legislators and regulators need to do everything they can to promote supply and conservation, not discourage them.

This viewpoint is based on experience, not just economic theory. The summer of 1998 illustrates the point. Then, wholesale electricity prices in the Midwest spiked up significantly. The Commission resisted pleas for immediate constraining action, such as price caps. Subsequently, suppliers responded to the market-driven price signals, and today the Midwest is not experiencing supply deficiencies.

In short, price caps can have long-term harmful effects because they do not provide appropriate price signals and may exacerbate supply deficiencies. Supply and demand cannot balance in the long-term if prices are capped.

In the context of California, today we have prices that reflect the fact that supplies are barely adequate. If we reduce prices, supplies will go elsewhere, risking greater reliability problems. Price caps will only aggravate the supply-demand imbalance.

In addition, capping prices based on individual seller costs likely would require lengthy, costly and contentious evidentiary hearings. Litigating such a rate case for one seller requires a significant commitment of resources. Concurrently litigating such cases for scores of sellers in the West would be overwhelming both for the Commission and the industry. Moreover, neither buyers nor sellers would be sure of the prices until the conclusion of this litigation. This delay in price certainty would be unfair to customers and discourage new investments by suppliers.

Many leaders share these views. In a letter to the Secretary of Energy, dated February 6, 2001, eight Western governors expressed their opposition to regional price caps. They explained that "[t]hese caps will serve as a severe disincentive to those entities considering the construction of new electric generation, at precisely the time all of us – and particularly California – are in need of added plant construction."

In the face of the current challenges, we all must have an open mind to any proposals that may mitigate the energy problems in the West. With respect to proposals for a West-wide cap, however, several points must be considered. First, any effort by the Commission to impose a West-wide cap will miss the large part of the Western market that is beyond the Commission's jurisdiction, let alone the other domestic and international markets. Regulating only one part of a market is unlikely to help, as investors and suppliers will simply focus their efforts elsewhere. Second, the price caps used previously in California were administratively easy to implement because California (unlike other parts of the West) has a spot market managed by a jurisdictional public utility. Absent such a spot market, price caps are much more difficult to implement and monitor. Third, a West-wide price cap as proposed by some would abrogate all existing long-term contracts containing higher prices. Historically, the Commission generally has been reluctant to take such an action, preferring instead to honor the contractual commitments that parties voluntarily make.

VII. Conclusion

The Commission remains willing to work in a cooperative and constructive manner with other federal and state agencies. Both the federal government and state governments have critical roles to play in promoting additional energy supply and deliverability and decreasing demand. Through its authority to set rates for transmission and wholesale power and to regulate interstate natural gas pipelines and non-federal hydroelectric facilities in interstate commerce, the Commission can take a range of measures to promote a better balance of supply and demand, but its jurisdiction is limited. The Commission can set pricing policies which encourage entry, but it is state regulators that have siting authority for electric generation and transmission facilities, as well as authority over local distribution facilities (both for electricity and natural gas). These authorities can go a long way in improving the grid for both electricity and natural gas. More importantly, state regulators have the most significant authorities to encourage demand reduction measures, which can greatly mitigate the energy problems in California and the West.

The Commission will continue to take steps that, consistent with its authority, can help to ease the present energy situation without jeopardizing longer-term supply solutions. As long as we keep moving toward competitive and regional markets, I am confident that the present energy problems, while serious, can be solved. I am also confident that market-based solutions offer the most efficient way to move beyond the problems confronting California and the West.

Thank you.

Commission Staff Summary of
Recent Commission Actions on California Electricity Markets

NOVEMBER 2000

- November 1: San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, 93 FERC ¶ 61,121 (order proposing remedies for California crisis on complaint of SDG&E)("November 1 Order")

- November 6: CPUC asks FERC to assist CPUC in investigation (Docket EL00-95-000)

- November 9: Public Conference re FERC-proposed remedies held in Washington (see 93 FERC ¶ 61,122)

- November 22: California Power Exchange Corp., 93 FERC ¶ 61,199 (order accepting amendments to streamline and clarify several provisions of the PX tariff)

- November 22: Pacific Gas & Elec. Co., 93 FERC ¶ 61,207 (order suspending PG&E transmission rate increase proposal)

DECEMBER 2000

- December 7:

  SDG&E files request for emergency relief re natural gas prices (Docket RP01-180)

  SoCal Edison files motion seeking to subpoena ISO Market Surveillance Committee data (Docket EL00-95-000)

- December 8:

  San Diego Gas & Elec. Co., 93 FERC ¶ 61,238 (order waiving operating efficiency and other regulatory requirements governing "QFs" and other small power producers to boost power output in California)

  December 8: California ISO Corp., 93 FERC ¶ 61,239 (order authorizing ISO tariff amendments to: (1) convert existing \$250/MWh hard cap on bids in the real-time market into a \$250/MWh breakpoint; (2) impose a penalty on generators who fail to comply with an ISO emergency order to provide power; and (3) assess costs against parties that underschedule demand or fail to deliver power.

- December 11 and 12: Motions for clarification, modification, and rehearing of December 8 ISO order

- December 13: SoCal Edison files motion for immediate modification of December 8 QF order

- December 13: California Power Exchange Corp., 93 FERC ¶ 61,260 (order accepting settlement re PX dispute resolution procedures)

- December 15: San Diego Gas & Elec. Co. (Complainant) v. Sellers of Energy and Ancillary Services into Markets Operated by CalSO and CalPX, 93 FERC ¶ 61,294 (Order adopting remedial measures to reduce reliance on volatile spot markets, including: (1) eliminating requirement that investor-owned utilities sell all their generation into the PX markets; (2) requiring 95 percent of demand to be scheduled in advance and establishing a benchmark for long-term contracts; and (3) imposing an interim $150/MWh soft cap or "breakpoint" on spot markets pending development of longer term price mitigation plan)("December 15 Order")

- December 18 and 20: SoCal Edison and PG&E file emergency requests for rehearing of December 15 Order

- December 20: Marketers file emergency motion for order requiring ISO and PX not to disclose confidential information (Docket EC96-1663-000)

- December 22:

  Dynegy files complaint alleging that rates paid for energy supplied in response to an ISO emergency order are confiscatory (Docket EL01-23-000)

  Dynegy files emergency motion for clarifications of December 15 order to ensure payment to suppliers (Docket EL00-95-006)

  Commission issues data request in response to December 7 SDG & E complaint re natural gas prices

- December 26: PX files request for rehearing and stay of December 15 order (Docket EL00-95-005)

- December 29:

  Southern California Edison Co., 93 FERC ¶ 61,320 (order analyzing and accepting SoCal Edison rates for scheduling and dispatching)

Pacific Gas & Elec. Co., 93 FERC ¶ 61,322 (order rejecting PG&E filing regarding its scheduling on the ISO)

San Diego Gas & Elec. Co., 93 FERC ¶ 61,333 (order accepting SDG&E rate filing re so-called "RMR" generating units–units that must run to assure system reliability)

Southern California Edison Co., 93 FERC ¶ 61,334 (order accepting RMR tariff for SoCal Edison)

California ISO Corp., 93 FERC ¶ 61,337 (order accepting ISO grid mgmt charges)

JANUARY 2001

- January 4: ISO files tariff amendment to relax its creditworthiness standards to allow PG&E and SoCal Edison to continue conducting transactions on ISO-controlled grid, notwithstanding downgrades in their credit ratings (Docket No. ER01-889-000)

- January 5: PX files tariff amendment to relax its creditworthiness standards to allow PG&E and SoCal Edison to continue trading in the PX markets, notwithstanding downgrades in their credit ratings (Docket No. ER01-902-000)

- January 8: San Diego Gas & Elec. Co., 94 FERC ¶ 61,005 (order clarifying that December 15 Order was not intended to bar the PX from engaging in bilateral forward contracting)

- January 12:

  Pacific Gas & Elec Co., 94 FERC ¶ 61,025 (order authorizing intra-corporate reorganization of PG&E Corporation)

  Sierra Pacific Power Co., 94 FERC ¶ 61,033 (order denying rehearing re priority use of certain California grid interties)

- January 16: California Power Exchange Corp., 94 FERC ¶ 61,042 (order authorizing PX to implement emergency tariff changes to allow SoCal Edison two additional days to make its payment)

- January 18: ISO files tariff amendment to conform to December 15 order re payment procedures for RMR operations (Docket ER01-991-000)

- January 19 through February 12: Various persons, including State of California and CPUC, file requests for late intervention and rehearing of January 12 order authorizing intra-corporate reorganization of PG&E Corporation (Docket Nos. EC01-41-000 and EC01-49-000)

- January 23: PG&E files motion for immediate order to stop PX from liquidating PG&E's long-term or "block forward" contracts after PG&E refuses PX demand for payment to cover a portion of SoCal Edison's nonpayment for transactions in the PX spot markets (Docket No. EL01-29-000)

- January 23: FERC staff conducts technical conference with industry representatives re spot market monitoring and mitigation plan

- January 25: Pacific Gas & Elec. Co., 94 FERC ¶ 61,082 (order denying rehearing request re PG&E transmission rates)

- January 29: San Diego Gas & Elec. Co., 94 FERC ¶ 61,085 (order finding PX in violation of December 15 order for failing to implement $150/MWh breakpoint)

FEBRUARY 2001

- February 1: Los Angeles Dep't Water & Power files emergency petition for reimposition of price cap on natural gas pipeline capacity (Docket RP01-222-000)
- February 2:

  SoCal Edison files emergency motion for cease and desist order preventing PX from liquidating SoCal Edison's long-term "block forward" contracts to cover SoCal Edison's nonpayment for transactions in the PX spot markets (Docket EL01-33-000)

  SoCal Edison and PG&E file for immediate suspension of underscheduling penalties imposed by December 15 order (Docket EL01-34-000)

- February 6: Mirant Delta files complaint with request for fast track processing that: (1) seeks enforcement of the creditworthiness standards for PG&E and SoCal Edison in the ISO tariff; and (2) alleges ISO violation of December 15 order for failure to replace governing board (Docket EL01-35-000)

- February 7: Pacific Gas & Elec. Co., 94 FERC ¶ 61,093 (order accepting settlement re PG&E transmission rates)

- February 8 and 12, and March 2: Various parties, including Coral Power, Enron, SDG&E, Salt River Project Agricultural Improvement and Power District, Sacramento Municipal Utility District, and Public Service Company of New Mexico file three complaints requesting that the PX be barred from further implementing tariff "charge back" provision that allows the PX to recover uncollected amounts owed by PG&E and SoCal Edison from other market participants (Docket EL01-36-000, EL01-37-000, and EL01-43-000)

- February 14: California ISO Corp., 96 FERC ¶ 61,132 (order rejecting ISO and PX tariff amendments relaxing creditworthiness standards for PG&E and SoCal Edison as applied to transactions affecting third-party suppliers)

- February 15: FERC staff meets with PX regarding requirements for implementing \$150/MWh breakpoint

- February 21:

  California ISO Corp., 94 FERC ¶ 61,141 (order accepting amendments to ISO tariff governing agreement among owners and addressing complaints by City of Vernon regarding conditions of becoming participating ISO owner)

  California ISO Corp., 94 FERC ¶ 61,148 (order denying rehearing of October 2000 order relating to ISO's transmission access pricing)

  Pacific Gas & Elec. Co., 94 FERC ¶ 61,154 (order denying intervention and rehearing of January 12 order authorizing PG&E Corporation intra-corporate reorganization)

- February 22: generators request order compelling ISO to comply with February 14 order re creditworthiness (ER01-889-002)

- February 23: San Diego Gas & Elec. Co., 94 FERC ¶ 61,200 (order on rehearing of December 29 order re assignment of RMR costs)

- February 26: PX files request for clarification/rehearing of February 14 creditworthiness order

- February 28:

  PX makes compliance filing proposing implementation of \$150 MWh breakpoint requirement; seeks rehearing of January 29 order (EL00-95-016; EL00-98-015);

  Tucson Electric files complaint against the Governor of California challenging California's "commandeering" of PG&E and SoCal Edison's long-term contracts from the PX (EL00-95; EL01-40-000)

  Complaint filed by Strategic Energy L.L.C. versus ISO concerning out-of-market costs (EL01-41-000)

MARCH 2001

- March 1:

  ISO files revised tariff amendment on creditworthiness in compliance with February 14 order rejecting earlier proposed amendment

  California Electricity Oversight Board files motion for clarification of December 15 order

  ISO and Electricity Oversight Board file motion for issuance of refund notice to sellers, request for data, and request for hearing

- March 2: Universal Studios files complaint against SoCal Edison challenging penalties Universal was charged for failing to interrupt its service under its interruptible service contract with SoCal Edison (Docket No. EL01-42-000)

- March 7 through 23: Various persons file second round of requests for intervention and rehearing of January 12 order authorizing PG&E Corporation intra-corporate reorganization

- March 8: Ridgewood Power requests emergency relief and extension of waiver of "QF" regulations applicable to small generators (Docket No. EL00-95-018)

- March 9:

  <u>San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CalSO and CalPX</u>, 94 FERC ¶ 61,245 (Order directing refunds or further justification for charges)

  "Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market" (Docket Nos. EL 00-95-012, *et al.*)

- March 14:

  "Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States and Requesting Comments on Further Actions to Increase Energy Supply and Decrease Energy Consumption (Docket No. EL 01-47-000) (order includes: (1) requirement that ISO and western transmission owners file list of grid enhancements that can be implemented in short term; (2) extension of waiver of QF regulations through December 31, 2001; (3) authorization for western businesses with back-up generators and customers who reduce their consumption to sell wholesale power at market-based rates; and (4) solicitation of comment on additional proposals)

Cities of Anaheim, et al. v. ISO, 94 FERC ¶ 61,268 (order dismissing in part and granting in part complaint alleging that certain cities are being charged inappropriate costs when ISO allocates the cost of power obtained through emergency orders to generators).

AES Southland, Inc., Williams Energy Trading & Marketing Co., 94 FERC ¶ 61, 248 (order directing parties to explain why they should not be found in violation of the Federal Power Act for engaging in actions that inflated electric power prices)

- March 15: Chairman testifies before the Senate Committee on Energy and Natural Resources

- March 16: San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by CaISO and CalPX, (notice re refunds for February transactions) (Docket Nos. EL00-95-18)

- March 20: The Commissioners testify before the House Committee on Energy and Commerce, Subcommittee on Energy and Air Quality

- March 21: Reliant files fast-track complaint against the ISO challenging the ISO's issuance of emergency orders requiring generators to supply power (Docket No. EL01-57-000)

- March 28: CPUC v. El Paso Natural Gas Co., et al., 94 FERC ¶ 61,338 (order dismissing portion of complaint alleging affiliate abuse but ordering public hearing on whether El Paso exercised market power to drive up natural gas prices)

- March 29: ISO files motion for order directing Reliant to keep generating unit in service (Docket No. EL01-57-000)

COURT CASES

- In re: Southern California Edison Co., No. 00-1543 (D.C. Circuit Jan. 5, 2001) (petition for writ of mandamus to order FERC to set cost-based rates denied)

- San Diego Gas & Elec. Co. v. FERC, No. 00-71701 (9th Cir.)(judicial review of November 1 and December 15, 2000 orders; motion to dismiss pending)

- In re: California Power Exchange Corp., No. 01-70031 (9th Cir.)(petition for writ of mandamus to stay Dec. 15 order)

STAFF INVESTIGATIONS

The Commission's staff has completed or initiated a number of public investigations, audits, and studies of matters relating to events in California, including:

- An audit of generation outages (report issued February 2, 2001)
- An analysis of the effect of a western region-wide price cap (released in early February)
- An analysis of causes of high prices in Pacific Northwest and California (released in early February)
- Ongoing analysis of market mitigation issues (pursuant to the December 15 Order, generators are required to file weekly market /cost data--starting January 10 and every Wednesday thereafter through April 2001--for Commission review and potential refunds; Commission has 60 days from each filing to give generators notice whether refunds required)

Mr. BURTON. Thank you, Chairman Hebert.

We will start with 5-minute rounds for questioning and we will have both sides stick with that rule.

Yesterday, the committee heard testimony from the president of ISO, Terry Winter. He said that on December 7, he made an emergency request to FERC to relax the hard cap because the ISO was not receiving enough bids to avoid collapse of the grid at the hard price cap. Is this why FERC issued the emergency order to relax the hard price caps?

Mr. HEBERT. Yes, it is, Mr. Chairman, but just to add a little piece to that.

I found it a little interesting—I understand there was some testimony given perhaps that it was something that happened almost in the middle of the night. Well, quite frankly, I find it a little discomforting that we are being criticized for acting judiciously and quickly. And the reason we had to do that was that the CEO, Mr. Terry Winter, of the ISO made it clear to us that in fact through that filing, if we did not move, the lights would go off.

Mr. BURTON. So what you are saying is if FERC had not responded to the ISO's request, what was the probability that there would be rolling blackouts starting in December was very real.

Mr. HEBERT. The probability was real and great, Mr. Chairman.

Mr. BURTON. So something had to be done.

Mr. HEBERT. Absolutely, sir.

Mr. BURTON. Is this why FERC followed up the December 7 order with the December 15 order to establish the soft price cap?

Mr. HEBERT. What we were trying to do through the December 15 order is set a point, the $150 soft cap, at which we would get some reporting requirements that would show us, and give us the opportunity to learn, whether or not in fact there might have been market manipulation. It did give us that opportunity, it is why we were able to act expeditiously and issue the refunds in January and February.

Mr. BURTON. Yesterday, the head of ISO, Mr. Winter, estimated that there would be a 3,000 megawatt shortfall this summer. What would happen if, under these circumstances, FERC ordered a hard price cap?

Mr. HEBERT. Mr. Chairman, I would love to give you a short answer. That is a very complex question and it is a very complex answer. I will do my best to make it short.

Mr. BURTON. Will it result, in your opinion, in more blackouts and more problems?

Mr. HEBERT. I think it will, not to mention potential blackouts in the West, specifically in Washington and in Oregon.

Mr. BURTON. So it is going to be a problem not restricted to California, it will be the whole Northwest area.

Mr. HEBERT. That is correct.

Mr. BURTON. And you think there would probably be more blackouts than otherwise?

Mr. HEBERT. I think that is correct, especially given the fact that, as I believe has been discussed in earlier testimony, if you look at the entire market, you are only talking about us capping about half of that market, a good portion of that tied up in bilateral contracts. So you are only talking about us capping the spot market, which in the end is only going to be about 15 to 20 percent of the market.

Mr. BURTON. You know what I wish you would do for the people of California and everybody who is concerned about this problem, is explain to them in your own words how supply and demand works and what would happen if FERC imposed a hard price cap here in California. I mean a lot of people are listening across this State and they are hearing all this terminology that they really do not understand. They know their prices are going up, they know there are blackouts, but I am not sure they understand the problem with energy being diverted elsewhere and hard price caps causing that energy to be diverted elsewhere, thus resulting in possibly more blackouts than they would otherwise have. So I think it is important that you explain that from your own perspective.

Mr. HEBERT. I think you certainly made it clear in that the energy is going to go where the caps are not.

Mr. BURTON. Where the money is.

Mr. HEBERT. Correct.

Mr. BURTON. Energy is going to go where the money is.

Mr. HEBERT. But having said that, that would even be true if we could cap the complete marketplace, which we cannot. As I told you, we can only cap around 15 to 20 percent of the marketplace. So what you do is you create two markets, so you understand that you cannot move in a positive direction when you do that.

Now the one thing that I think is not being communicated to the good people of California is the fact that when you say you are going to have a hard cap, implicit within that remark—what that person has said is there is a point at which we are not going to pay for the electricity and we are going to turn your lights out. There is a point at which we say enough is enough and your lights are going out.

The problem with that, as I see it, and as we are learning through this process, in California, the argument is that you cannot just have a California price cap, it has to be a Northwest price cap. The reason for that is because the West is a natural market, and that is absolutely correct, they are correct on that in California. The problem with it is that whereas California wants a cap, I have got a letter here I will be glad to put into the record from 9 Governors of the 11 in the West, who say they do not want price controls in their State.

Mr. BURTON. Without objection.

Mr. HEBERT. I had a conference yesterday in Boise, ID with the 11 State commissions as well as representatives of the Governor's office and this tally was not taken by me, it was taken by a staff member, so it could be objective, and of the 11, only 3 favored price caps.

I guess the real question is do we feel we are better suited in Washington, DC, to make decisions for these local people. And I think that is a real dilemma. Are we willing to say, quite frankly, we are not going to let you decide when to turn the switch on or off. We think we are smarter than you in Washington, DC, and we are going to decide, there is a price at which we are going to turn it off for you.

I would submit to you I think that is improper, I think it sends the wrong signal. Now that is not to say that the Commission is not looking at price volatility. That is why we were out there yesterday, that is why I was in Denver the day before, it is why you have me here today. We have made it clear through our refunds in January, through our refunds in February, we are going to look at refunds from October to December and we are also putting forth a market mitigation plan as of May 1 on a going-forward basis. It is just the hard cap sends us in the wrong direction.

Mr. BURTON. Thank you.

Mr. HEBERT. Thank you, sir.

Mr. BURTON. Ms. Lofgren, do you have some questions?

Ms. LOFGREN. Thank you, Mr. Chairman.

I believe that there is more agreement on some of these issues than is generally understood. I think that everyone in California who has paid attention to this understands that we do have a supply and demand problem and that is absolutely clear. We had phenomenal economic growth in this State that really no one predicted and we had growth in our neighboring States that surprised us as well. And so energy demand just skyrocketed. That is the upside of a great economy, is the shortfall in energy. And for a variety of reasons, supply did not meet demand and so we have a problem.

We have nine power plants under construction right now in the State and there are going to be more that will be needed and I think there is general agreement about that.

We also, I think mostly, do believe in supply and demand and market forces here in California. This is sort of ground zero for the entrepreneurial spirit in California, here in Silicon Valley. However, many here in California, including the Governor, the California delegation, both Republicans and Democrats agree on this as you know from the last meeting we had with you in Washington, that we do need to, as part of the picture, gain control of this out-of-control market. We do not have a functioning market right now and part of the answer—not the silver bullet, not the solution to the problem, because that is supply and demand, is to gain control of price gouging that is going on right now, so that we can move forward.

And so I was interested in the—obviously I was not at the hearing yesterday in Sacramento, but Mr. Winter of the California Independent System Operator indicated that the wholesale energy prices since January—this is his testimony—have exceeded the cost necessary for new investment by 400 percent. And that, in his judgment, this would allow for the recovery of an investment in new supply in the period of less than 2 years.

So clearly the price spikes would be an incentive to invest, but that has not necessarily occurred. And my sense is that the market is so wacky that it has chilled the possibility of investment because the State might have to take dramatic, I mean very unusual, steps. And so perhaps there might be a way to put the rhetoric to one side where we could work out with FERC an ability to get control of the price gouging for a temporary period so that we can get through this.

What would your comment be on that kind of approach, Mr. Hebert?

Mr. HEBERT. Let me say two things. One, meeting with the California delegation that obviously you are a part of, I can assure your district you are doing everything you can and I appreciate the attention you have paid to this, but I will tell you—I am obviously trying not to be rhetorical, that is why I am telling you there is a plant that we are looking, that we are moving forward with. We are quasi-judicial, we cannot come out with that right now, it is something that hopefully we are going to have in place before May 1. It is not a hard cap, it is something called a mitigation measure and I think it will work. But when it comes to the wackiness of the industry and the fact that you see these huge prices—now I am not exactly sure of the numbers Mr. Winters talked about and I would like to see those. But I will tell you this, it does not matter if it is electricity, it does not matter if it is widgets—uncertainty in a market is very unsettling to investors.

You keep changing the rules on them—you hear these discussions about cost-based rates. Well, some of these people are not looking to invest in anything that is going to return them on a cost-based rate scenario, that is going to be based on some 30-year average, not to mention it is hard for us to turn that around and do it again. But I will tell you the market uncertainty has everything to do that.

And it is great to hear about these generators that they finally permitted, but it will be great when they turn one of them on. That will be significant and that is what we have got to get done.

Ms. LOFGREN. We are looking forward to that, believe me.

Mr. HEBERT. I know you are. But the other thing, you have got path 15——

Ms. LOFGREN. Yes.

Mr. HEBERT [continuing]. Huge transmission problem in the State of California. How many studies must be done before someone invests another dollar in it and does something so you can move electricity in the other direction.

Ms. LOFGREN. You are correct on that——

Mr. HEBERT. And I know that is not your fault, I am not blaming you.

Ms. LOFGREN. No, but part of the issue is that we had tremendous profit-taking after the sale of generating assets, none of which was reinvested into the infrastructure. I think maybe—well, it is going to be up to the State of California, not up to the California congressional delegation, or probably up to you, but some investment in that infrastructure clearly does need to be made and I think everyone is aware of that.

I think my time is about over, but I am encouraged by your comment that we might be able to move off of the rhetoric and get into a—whatever you want to call it—a stabilization effort having to do with prices that will allow that aspect—not the whole solution, but that aspect to be dealt with.

Thank you very much, Mr. Chairman.

Mr. HEBERT. My general counsel would like to make one followup if that is all right, Mr. Chairman, or would you rather move on? We can move on, we can submit later.

Mr. BURTON. Let me just say that we will have a second round if you have more questions, Ms. Lofgren.

You may proceed and make your comment.

Mr. MADDEN. Yes, I would like to make one comment.

When the generators were sold, they were sold at a premium, the were sold at substantially above book. And as Mr. Winter testified yesterday with respect to what he believed was not competitive prices, I think by the time we finished the hearing, the numbers had come down substantially, from a $6.7 billion figure to almost a $1 billion figure. And we can get into that.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

Mr. Madden's comment is timely. Yesterday we did hear about discrepancies between the Cal ISO report and FERC's analysis on the issue of overcharges. One of the things I am concerned about is at some point or another, this issue dealing with Southern California Edison's proposed sale may very well come before FERC and we will be asked to provide input for the record.

And what I am trying to get to is a clear understanding of the number that took place. Can you elaborate on the flaws, as you see them, in the Cal ISO report? And let me just briefly describe them, as I understand the discrepancy. The Cal ISO report, I think the actual number is $6.2 billion, it uses assumptions that we cannot quantify specifically, it encompasses the entire market, both bilateral contracts—excuse me—bilateral contracts, non-jurisdictional entities and jurisdictional entities. And I am having a hard time figuring out what is the right number.

And the reason I ask that question is that Cal ISO's own attorneys have provided a letter that we have a copy of that says the only amount subject to FERC jurisdiction is $1.3 billion. So I mean, you can understand my confusion here. I asked this question yesterday. Can you elaborate on this?

Mr. HEBERT. Well, Congressman Ose, I think Congresswoman Lofgren made a good point about the rhetoric. So much of this, especially when you talk about numbers, it is what can we throw out there to make the press feel good about what we are doing. $6.7 billion sounds a little bit better than $1.3 billion, does it not? And I think that is what much of that is about, but to walk you through it quickly—and I jotted these numbers down—we sent out a memo, I think it was sometime last week, through the general counsel's office, requesting the information from the ISO to break those numbers down. I have not seen that yet, but I will tell you $4 billion of that goes through the PX and the ISO market, $2.7 of that is bilateral contracts that you spoke of, not subject to us, and $3.1 of that is FERC jurisdictional, but $1.8 of the $3.1 is beyond our authority.

Mr. OSE. All right, you have lost me here.

Mr. HEBERT. Sorry.

Mr. OSE. You have got $4 billion that goes through the ISO and the PX, and of that $4 billion, $2.6 billion is non-jurisdictional?

Mr. HEBERT. $2.7.

Mr. OSE. $2.7, all right. So we separate the market out that way.

Mr. HEBERT. That is part of what comes under FERC.

Mr. OSE. All right, go on then, to on with your numbers.

Mr. HEBERT. My general counsel has seen the numbers, so if he has got something to add, I am going to let him here.

Mr. MADDEN. Mr. Winters, finally yesterday, increased the $6.2 million to $6.7 because he included an additional $400 million for ancillary services. So let me start with that.

Of the $6.7 the, he took out approximately $2.7 billion because they were bilateral contracts. Some of those are subject to our jurisdiction, depending on who entered into those bilateral contracts, but the whole issue is people going forward. And these were contracts that in many cases even the CPUC approved. So if you take that out, you then come up with a number of $3.1 for FERC jurisdictional from the October to February period. Then $1.8 billion of the $3.1 billion is before October 2 and we do not have refund authority for that. Correct? So then we have a remaining portion of $1.3 approximately. Now that represents the 5-months, October through February. We have refund for just 2 months, January and February, which was $124 million.

So we're about $1 billion off, a little bit more than $1 billion in terms of our numbers right now. Then you have got to look at the ISO has looked at all the hours that the generator ran during that period versus our belief that you look at a different period, a period where there supply and demand does not cross, which is substantially much less. And then we do not know what gas numbers or No_x numbers they used. So until they supply that information, will we be able to clearly define what really is the differentiation between their number and ours.

But I want to point out this $6.2 or $6.7 is clearly now, the public should know, is totally out of whack and it is more in the $1 billion range and most likely it will come down substantially more.

Mr. OSE. Thank you, Mr. Chairman.

Mr. BURTON. Mr. Honda, I understand you have to be someplace at 11, so we will recognize you now.

Mr. HONDA. Mr. Chairman and Mr. Hebert, thank you for coming.

We have all heard comments about the discussion about caps. We discussed it a little earlier about hard caps and soft caps. And I am not so sure even folks in the community understand the difference anyway. The bottom line is that the rates have gone out of sight and FERC has the responsibility and it is public that FERC had said upon your examination of the situation that the rates are unjust and unreasonable, I think that is a fair quote.

Commissioner Massie had submitted a written testimony as far as his solution, his perspective of the situation, that there is no marketplace and therefore there is no competition, and I tend to agree with him. There are two things happening right now and they are parallel. One is groups are looking and seeking for a long-term solution which we need to do, and then we are looking at a short-term solution, which I am looking to FERC to help us with. We have some bills that have been submitted asking for relief, temporary relief, that we cap the costs, considering cost of production of energy plus a profit and that this bill has a sunset date of 2003. And that would mean that it is temporary.

Now your discussions in the past have always been you want the marketplace to determine the prices and in your discussion just earlier, you talked about hard caps. My question to you is when you talk about hard caps and the comments you are making right now, it sounds like theoretically you are talking about a long-term continuous situation rather than looking at the immediate solution.

I am concerned for the constituents of this State, the immediate short-term relief until we get a long-term solution. And I would like your response there.

Mr. HEBERT. Congressman Honda, I think that is an excellent question, and what I would like to do is explain to you some of the misconceptions in regard to what the Commission has done in regard to actually what my comments have been.

You quoted the fact that there have been market power issues and a manipulation of the market, or unjust and unreasonable rates. And I think the quote that may have been shared with you is that we found that. Yes, that is true, but it is a little bit—since we are here at a university—like quoting first kill all the lawyers without saying what is in front of that quote. It does not give you the full explanation of what the author was talking about.

What we said in our order was that we found rates to be unjust and unreasonable at certain times and under certain conditions. That is not to say that they all were. We have moved forward on that. What is so interesting about the price cap debate—and I really think this is just someone's artful way, I have to give them a lot of credit—of keeping the debate away from what it should be and about supply and about demand and getting things done, because most people, when they talk about these price caps, they look at New York and they look at New England, they look at PJM, which has $1,000 price caps. Well in January and in February, in January, we set subject to refund everything over $273—much less than $1,000. In February, we put everything subject to refund over $430—much less than $1,000. But I want to assure you, sir, this Commission is working to come forward with something on a going forward basis of May 1, on price mitigation. We are looking at that, it is not that we are not paying attention, we certainly are and we are prepared to move forward.

But when it comes to cost, let me close this gap for you, because this is important. So many people want to talk about moving away and going back to cost. One of the reasons we moved away from cost is what Congresswoman Lofgren brought up and that is investment, to get the opportunity, to get the choice. Another real reason is quite frankly because we get so bogged down. I have got rate cases at the Commission right now—I was left with a backlog of 2,000 cases that we are trying to deal with, some that go back to 1993. California needs help now, the West needs help now. Cost-based scenarios do not get you help now. I do not think you can wait 8 years for a remedy.

Mr. HONDA. Thank you, Mr. Chairman, if I may continue on my time.

The next question then is when FERC decided to put a cap, a temporary cap a couple of months ago, you indicated that you would do it at $150. But it was at stage three and I think that consumers want to have a cap on all the stages and not only a stage three, because if you want to cap at a stage three, whether it is soft or hard, it still increases the rates for our consumers. We need to have ways to be able to anticipate the cost of our energy when we consume it. And as consumers, we do not know what that price is going to be and that is unfair in the marketplace and the marketplace is dysfunctional, and that is a quote, it is dysfunctional at this time and that is why we have to work on a long-term solution, so that the market is functional and that there is competition and that will be able to drive the prices down. But apparently it is dysfunctional and when you start to talk about price caps, it is my contention that it should not only be on stage three, but it should be all stages, so that you really truly have a lower rate.

Mr. HEBERT. Do you want me to respond to that, sir?

Mr. HONDA. Well, you said something about in the near future you are going to come up with some sort of interim solution. Hopefully the interim solution does not relegate itself to stage three, but an across-the-board, firm kind of pricing that the consumers can anticipate in the future.

Mr. HEBERT. We issued an order on price mitigation and actually the comment period closed about 2 weeks ago. We are looking at that now and going to move forward.

Mr. HONDA. Thank you, Mr. Chairman.

Mr. HEBERT. Thank you.

Mr. BURTON. Thank you, Mr. Honda.

[Inaudible comment from the audience.]

Mr. BURTON. We are here to hear from the panelists who we have asked to testify and we had not made provision for public input; however, if any of you would like to submit to us in writing information or concerns that you have, we would be very happy to have those.

VOICE. I did, to our Congressman.

Mr. BURTON. Well, I will be very happy to take that and that will become part of the record. So any of you that have comments or things that you would like, be sure to get those to us, and make no mistake about it, we are going to review everything that we have. But the problem is, because of time constraints, we simply cannot have everybody testify.

VOICE. Just because our questions are entered into the record does not mean we are getting answers. We are concerned that FERC approved billions of dollars going to PG&E, to the parent company, now they have declared bankruptcy, are they going to rescind that so PG&E can pay their bills?

Mr. BURTON. Ma'am, I think your question has been heard and we will see if we cannot have a response to that in just a minute. But if you have other questions, get those to us and we will see if we cannot find some format that we can get them back to you, but we do not have time to have questions from everybody in the audience right now.

Let me see—Mr. Horn.

Mr. HORN. I yield 30 seconds.

[Inaudible comment from the audience.]

Mr. BURTON. Ma'am——

[Inaudible comment from the audience.]

Mr. HONDA. Mr. Chair, I believe my colleague Mr. Horn had conceded 30 seconds to me.

Mr. BURTON. 30 seconds.

Mr. HONDA. Let me just share with the community that I will be submitting this in writing on your behalf and any other questions that the community may have. And I think that the frustration of the community is reflected in the outspokenness of some of the folks that had to leave. I share their frustration, I think more than they share this frustration, Mr. Chair, so on their behalf, I will be submitting these questions and I have their names and addresses and you will receive a response from the FERC. Thank you, Mr. Chair; thank you, Mr. Horn.

Mr. HORN. Mr. Chairman, I would like to have you clarify for the record, we are talking about hard caps, soft caps, I begin to think I am talking with the three bears. So just what, in your judgment, as chairman of that very important commission, do you feel and what did the Governors you met with feel—I think it was 3 out of 11 that had a cap interest—could you sort of define for me, will a soft cap always become a hard cap or what?

Mr. HEBERT. A soft cap does not always become a hard cap. Once it is in place, it is a soft cap, as the $150 was, with a reporting requirement. What it did was bids that arose above the $150 mark would not set the clearing price, it would come back down to $150, therefore, not setting a high market clearing price. Whereas a hard cap is a hard cap at which no purchases can be made beyond that.

Mr. HORN. And does the Commission have any view to maybe do one or the other on this? Or what will it take to not do it or to do it?

Mr. HEBERT. Congressman Horn, my thoughts have been, as the Commission has been clear in looking at market mitigation, that is the direction we need to move in. That is the direction we are moving in, that is why we had the comment period and that is why we are trying to come out with something before the May 1 period. We felt so strongly about that we placed in one of our orders, Order 2000, where we are trying to set up regional transmission organizations, which every State in the United States of America has filed with us, save one—California. They are the only one that has not filed.

We put in that plan, in Order 2000, that in fact the RTOs would have additional market monitoring obligations, so that would shore us up as well. We are moving in that direction, I think the market mitigation is the answer, it will send the proper signals to the investment community, it will make sure and keep prices, I believe, at a level that would mimic a competitive market when things get extremely tight like we were talking about in a stage three, when reserves are at 1.5 percent, when in fact your curves are about to do this, when supply and demand do not cross and in fact the lights go out.

Mr. HORN. When California did not reply and the other 49 States did, was there any action by the Commission to request the Governor or the Commission, the Public Utilities Commission here, to respond on that? Or what do you think, why aren't they responding?

Mr. HEBERT. I would certainly be living within the realm of speculation to assert why I think they are not acting, but I will tell you we have communicated. I as recently as yesterday, not only phoned the Speaker of the House, the Pro Tem as well, as well as one of the new Commissioners at California, and they said that they could use someone to communicate more with them. And I had a gentleman behind me by the name of Shelton Cannon, who works closely with me, I gave them the name and number and I said let us get this together and let us move forward.

Mr. HORN. Let me move from this to natural gas. There has been interest in the capacity of natural gas to providing a certain amount of megawatts and I wonder if the Commission has some analysis where the natural gas would be a certain portion of providing electricity, and I wonder what is the view as to how much an importance natural gas is, and are the States who can also regulate pipelines doing what they should be doing, has there been sort of a view of some that we will just keep moving other things through those pipelines and it will not be natural gas? So what is the Commission going to be able to tell us on that?

Mr. HEBERT. Well, what we have done, as I had said earlier, we are expediting any and all applications that come before us for the West and for California. Kern River is a great example of that, acting on that in 3 weeks. I would also have to commend some other Federal agencies that helped us get that done.

At the same time, the natural gas price, which under most scenarios of combined cycle, is about 70 percent of the price of the megawatt hour. That being said, the price of natural gas has everything to do with what the price of a megawatt is going to be. Having said that, you must understand, and I think you do, that in the end it does not matter if I get the West 100 pipelines, if I get California 100 interstate pipes. They have got some takeaway problems. In other words, I have got a big pipe that brings it to them, and their takeaway capacity is much less; therefore, they cannot move it and it inflates their prices. Not to mention they did the same thing in the natural gas markets that they did in electricity, they played the spot market. They did not have a balanced portfolio.

Mr. HORN. Thank you, Mr. Chairman.

Mr. BURTON. Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

I think you are quickly dispelling the notion that many have had that California's energy problems really are our only concern here in California. Modern energy systems, by their nature and design, cross State borders. Oregon, Washington and Arizona are already directly caught up now in this so-called California problem and problems now have emerged in New England and New York and elsewhere in the country. So it is clear that energy cannot be treated as just another free market commodity.

Now you mentioned earlier your concerns with regard to Washington, DC, and FERC in terms of putting on caps because it is a regional problem, but the region actually, as I understand it, does not have the jurisdiction over wholesale rates.

Let me just ask you, Mr. Hebert, am I correct or not; is FERC the only entity with that type of power and authorization in terms of the wholesale rate price capping?

Mr. HEBERT. We do have the wholesale rate authority, but as I suggested to you, with Public Power, BPA, which—municipalities, which take up about half of the power in the West, we do not have authority over. But yes, you are right.

Ms. LEE. So it is FERC that we need to look to. Otherwise, what entity?

Mr. HEBERT. Well, you could certainly look to BPA, you could certainly look to municipalities, you could certainly look to other Public Power entities where we do not have jurisdiction.

My general counsel wanted to add something.

Mr. MADDEN. When we discussed yesterday the $6.7 billion, approximately $1 billion of that was associated with co-ops and munis—LA, DWR and SMUD. Yes, the cities can do something about that, the munis can do something about that. They, if they want, can lower the price to provide better prices to the consumer. We do not have jurisdiction over them, but they can do it.

Ms. LEE. In terms of wholesale rates?

Mr. MADDEN. In terms of the energy that they sell at the wholesale level, yes.

Ms. LEE. Let me ask you about the finding, going back to Congressman Honda's question with regard to the fact that you did find—and as you said, at sometimes under some conditions, under certain conditions, that generators have exceeded just and reasonable wholesale prices—since that finding was made, let me just ask you, under—since it was only under certain conditions, have you, under certain conditions, assessed penalties against the generators that have been found to exceed the just and reasonable wholesale prices? Or what is going on at this point with regard to the generators?

Mr. HEBERT. We have got some matters subject to rehearing, so I want to be careful, but yes, we have. That is in fact—we acted in January, we acted in February, we are getting ready to act on the time period between October and December where, if you will remember right, we did not have the reporting requirements that we had on everything above $150, so it has taken us a little more time to get the information together. But we will get that information together and we will act.

But there is some misunderstanding that if FERC has not acted in the capacity of a cap or something else, that we are not doing anything. I can assure you that this Commission is looking for and is ready to make certain that there is not market manipulation; and if so, we will provide relief.

Ms. LEE. But again, have you assessed penalties or not? Or are you still trying to determine what the level or amount of penalties should be, as a result of your finding?

Mr. HEBERT. Penalties in the sense of a refund.

Ms. LEE. But not against the generators?

Mr. HEBERT. The refunds will be made by them, yes.

Ms. LEE. OK, when will we know what that amount is, how much that is and what that will add in terms of refunding?

Mr. HEBERT. Right now, as I told you, under the January and February, we were at $124 million, I think in my testimony, I told you about another additional $10 million. So the numbers are adding up. And we will act on March, we will also be acting on October through December.

Ms. LEE. OK, finally let me just ask, in terms of regulatory practices, given again your findings, how, in terms of your regulatory efforts, are you going to ensure just and reasonable prices? Are you taking steps now to correct that in addition to the assessment of penalties?

Mr. HEBERT. Well, again, the penalties come in the form of refunds and yes, that is exactly what those orders are about. I mean we—as I have told Congressman Honda and——

Ms. LEE. But are there any regulatory reforms in place now?

Mr. HEBERT. Well, the reforms that hopefully we will have in place by May 1 will be the market mitigation that I have spoken about. Again, the RTOs, when we get them up and running, hopefully that will be soon, we certainly need a filing from the State of California, would have additional market mitigation through market monitoring as well.

Ms. LEE. I think, Mr. Chairman, what is very important is that the short-term solution happen immediately, as soon as possible, and that consumers do see a refund coming right away, because it is going to be a very hard, hot summer this year, I think. And while we work on hopefully a national energy policy, which is what we need, short-term, I think consumers are going to need a refund, especially low-income individuals, people on fixed income, senior citizens. They need those refunds in their pocket right away so they can just manage to get through the next 3 or 4 months.

Mr. HEBERT. I would agree with you and I will tell you that President Bush has been very clear as to his commitment, I know the committee has as well. We are doing everything we can on our part to make sure that those people are protected as well.

Ms. LEE. It is my understand though that LIHEP was frozen in the budget, I do not think we see an increase in LIHEP funding.

Mr. HEBERT. I cannot tell you what they are doing with an increase or not an increase, but I can tell you the commitment from the last is brought forward.

Ms. LEE. Thank you, Mr. Chairman.

Mr. OSE. As it relates to the LIHEP line item in the budget, I would be happy to work with you to ensure that California's low income and senior citizens are eligible to file under that.

Ms. LEE. Thank you very much. I look forward to working with you on that because as I understand the budget, it is frozen at the previous levels and we do need to work to ensure that there is an increase for California consumers. Thank you.

Mr. BURTON. We will start a second round. As I understand it, we probably have another 45 minutes of your time. Does that sound about right to you?

Mr. HEBERT. I think I have got about another 20 or 25, Mr. Chairman, but if you need me, I can——

Mr. BURTON. I think if we stick to the 5-minute rounds, we can get through, if there are five of us, we can get done in about 25 minutes.

Mr. HEBERT. Thank you, sir.

Mr. BURTON. As I understand it, the California ISO now says there were $6.7 billion in overcharges and we have not seen exactly what they are basing that on, but that is their opinion. Of that, you are saying that there is only $1.3 billion more or less than you can do anything about.

There are lots of electricity sales that are outside of your jurisdiction. Can you give us some examples of that as well as that difference we are talking about?

Mr. HEBERT. Well, the sales absolutely that we are looking at as far as entities outside of our jurisdiction is what the general counsel had mentioned earlier, we have got munis, we have got co-ops, we have got BPA, Canada as well which comes into the market and actually you have had BPA try to say they can do what they can, but as well as you know, they are looking at rate increases themselves right now. The Secretary of Energy has been very specific that they are going to have to meet their revenue obligations.

Mr. BURTON. What percentage of the power here in California, do you have jurisdiction over?

Mr. HEBERT. What percentage? Roughly half. But if you are talking about capping the market, there would be no way to cap those bilaterals, so if you are talking about existing bilateral contracts, you take the spot market out of that, you are only talking about us capping maybe 20–25 percent at most.

Mr. BURTON. OK, so there is only 20 to 25 percent that you could cap. Let us say that there is a tremendous energy shortage and we anticipate that across the State, and you cap 25 percent. What is going to happen then? They are going to send it to the other 75 percent where they can get a higher rate, right?

Mr. HEBERT. That is correct.

Mr. BURTON. OK, I hope everybody understands that. If you can only cap 25 percent of the State market and there is a tremendous need, and the other parts of the State, the other 75 percent, is willing to pay more than the cap that you put on the 25 percent, then you can bet your bottom dollar, the people who are selling the energy that is necessary to produce more energy are going to go to the 75 percent that is not under the cap, correct?

Mr. HEBERT. Correct, not to mention out of State.

Mr. BURTON. That is important. I think everybody needs to know that, because they are going to go where the money is.

Now as I understand it, you cannot review sales before October 1 of last year. Can you give us a layman's explanation as to why that is that you cannot?

Mr. HEBERT. Well, when the utility filings come in, in dealing with—I am going to put it in layman's terms—what we are dealing with right now, there is a 60-day period, we are prohibited from going beyond that 60-day period. That is at the point at which it was filed. Was it October 2 exactly? I think it was the second.

Mr. MADDEN. San Diego Gas & Electric filed a complaint August 2, so we, in our order October 2, established the earliest possible date under the act, 60 days after a complaint was filed.

Mr. BURTON. So you are limited to 60 days.

Mr. MADDEN. That is the earliest period.

Mr. BURTON. Now I understand that you have ordered refunds for January and February. Are you currently investigating transactions for other months?

Mr. HEBERT. Yes, sir, March, and then the period from October through December, and then again, we are looking at the market mitigation, May 1 going forward.

Mr. BURTON. And when do you expect to issue orders for those months that you are currently looking at?

Mr. HEBERT. Whereas I am prohibited from giving you exact dates, Mr. Chairman, I will tell you I have instructed my staff to move with all deliberate speed and get them out quickly.

Mr. BURTON. One final question and then I will yield to my colleagues. Yesterday, we ran into some stonewalls from the State as well as your agency on some information that the committee requires. We understand that that has to be kept confidential, but it will be helpful in our deliberations and we will have your cooperation to get that?

Mr. HEBERT. You will have my cooperation, Mr. Chairman. Anything that you request, I will be glad to give you under cover. I think it is important you see many things.

Mr. BURTON. OK, thank you very much.

Ms. Lofgren—1 more second. One question further. How aggressively do you intend to move to get those refunds from January and February? You said as quickly as possible.

Mr. HEBERT. We are in that process right now.

Mr. BURTON. OK, has your ruling been challenged?

Mr. HEBERT. It is on rehearing at this point. So yes.

Mr. BURTON. So what is the next step?

Mr. HEBERT. Well, the rehearing, hopefully we are going to deal with that as quickly as possible. They obviously will have their right to appeal. Like any other court of appropriate jurisdiction, there are appeal rights that go beyond that——

Mr. BURTON. But you are going to move as quickly as you possibly can.

Mr. HEBERT. We are going to do everything we can to get it out from under us, yes.

Mr. BURTON. Ms. Lofgren.

Ms. LOFGREN. Thank you, Mr. Chairman.

Just thinking about this, there are some, I think, simple things that the people of California want done, and that is for our agency, since I think you are the only ones who can do it, to aggressively recoup the unjust and unreasonable prices that have been assessed against California consumers. And along those lines, I am interested—and I understand the current act precludes you from looking past October, but clearly there was very—in my judgment, very questionable activity that occurred prior to October. Just before recess, members of the Washington, Oregon and California delegations came together and introduced a bill that would change the act and allow you to go past the October date that is currently in law. Would you support that bill or what would your reaction be to that?

Mr. HEBERT. Congresswoman Lofgren, I have not read the legislation; therefore, I would not want to say if I support it or not.

Ms. LOFGREN. That is fair enough. Could I ask you to read it and consider supporting that?

Mr. HEBERT. I will commit to that and if you would like a response on that, I will be glad to give that to you.

Ms. LOFGREN. I would very much appreciate that.

Second, I think, Congresswoman, we touched on this as well, but ISO has indicated to—Cal ISO has indicated in their testimony that market manipulation is going on, not just during stage three emergencies but also during stage one and two, and they are suggesting that FERC needs to look at those, not just stage three, but also one and two for market manipulation and price gouging. Are you prepared to do that? Can you do that under the act?

Mr. HEBERT. Congresswoman Lofgren, this has been one of the huge misunderstandings. In the dead of the night when we are all asleep and rates are lower, we are looking for market mitigation which also includes one, two and three. We are always looking for market mitigation.

Ms. LOFGREN. So your answer is you will accept and you would order rebates if you found unjust even in those stages. That is just a confusion?

Mr. HEBERT. Absolutely. We are continually looking for market manipulation and misconduct.

Ms. LOFGREN. That is great to hear.

Finally, you know, I saw today that President Bush had figured out the right words to use so that the Chinese Army could be happy about an apology. So it seems to me we could figure out the right words to use that will allow FERC to control, proactively and prospectively, price gouging. And I guess the question is, is the term "market mitigation" the right word for your proactively controlling prospective price gouging, which California needs you to do?

Mr. HEBERT. That is correct. What our intent is, and again, we have not ruled on this yet, we sent out for comments—it closed out 2 weeks ago, but our intent is to find a process by which we can mitigate market conduct based on what a market would be doing if it were functional, even during a dysfunctional period, taking certain factors into consideration. So, yes.

Ms. LOFGREN. All right, finally, you know, we read in the paper and we do not know obviously all the details, but it appears that some of the energy companies have just made extraordinary—I mean extraordinary—profits at the expense of California consumers. Duke operating revenue more than doubled from 1999 to 2000. Reliant had a 1,685 percent increase in operating income. So I am hopeful that we can see some of this revenue, as the complaints are made, flowing back to the State so that we can have the financial ability to make the investments that are required. At the end of my last questioning period, I was commenting about the sale of the generating assets and, you know, without saying whether the price was right or wrong, I mean, there was a tremendous amount of money that came into PG&E and they did not invest that money in path 15 or anything else, it just went back to the parent corporation. So we need to be able to recoup some of the gouging, get the money back, take care of the suffering consumers in California, but also make some of the investments that are going to keep us healthy in the future, including path 15. I am hopeful that we will be able to get the prospective control of prices that will avoid the necessary delay of the regulatory and review process for the refunds.

Mr. HEBERT. Let me say a couple of things about that. One, the PG&E is on rehearing, so I would have to be very careful about making comments. But I will tell you it is my understanding that several of those companies have made commitments to reinvest capital, do not know to what extent, cannot quote to you which companies they are. I know you are going to have them later to talk to you.

Many of those decisions when it comes to reinvesting capital and what you do with that investment dollar is made with CPUC.

Ms. LOFGREN. I understand that as well as with Public Power, but you understand the California consumers feel a bit ripped off right now.

Mr. HEBERT. Well, and the CPUC could change some of that, yes.

Ms. LOFGREN. Thank you, Mr. Chairman.

Mr. HEBERT. Thank you.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

I want to followup on something that Congresswoman Lofgren said. If it is your point that when a filing is made with FERC to remove that 60-day delay by legislation, that makes eminently good sense to me, that the analysis ought to start from the date of the filing rather than 60 days hence, and I appreciate you bring that forward and I would like to visit with you about that later.

Mr. Hebert, on FERC's jurisdiction over bilateral contracts, does FERC have the authority to reverse bilateral contracts?

Mr. HEBERT. Yes.

Mr. OSE. Is it statutory or regulatory rulings that give you that authority?

Mr. HEBERT. Well, through the Federal Power Act, we have the authority, but I will tell you it is only subject to wholesale, which gets us back to where we were talking about before, as to the percentage of the marketplace.

Mr. OSE. The 47/53 break?

Mr. HEBERT. Correct.

Mr. OSE. Mr. Chairman, I am not sure we did this yesterday, but I do want to enter into the record, this letter from Cal ISO's counsel that says the only amount of overcharges that is the subject of FERC's jurisdiction is $1.3 billion.

Mr. BURTON. Without objection, so ordered.

Mr. OSE. And then finally, I want to again come back to this article in the LA Times this morning about—I do not know if you have read this, but there is an article here by Robert Lopez and Rich Connell and I see it is not copyrighted, so we may well be able to put it in the record, about the context of these municipalities—in the context of municipalities selling power to the ISO during times of market emergency. This article suggests that in particular the Department of Water and Power has engaged in some of that activity. It is my understanding that they are outside your jurisdiction?

Mr. HEBERT. That is correct.

Mr. OSE. This speaks right to the heart of one of our problems here, Mr. Chairman, and that is FERC has jurisdiction over 47 percent or 53—pick your number—and then they have jurisdiction over some of the bilateral contracts, but not others. And I find it most difficult, as I did in my earlier round of questioning, to understand the usefulness of the original six point whatever billion number that was created in FERC's report. I am trying to get to the hard number, so we can talk specifics about how to address it.

Now I want to make sure I have got this. Pursuant to Mr. Winter's testimony yesterday, ISO is saying there are $6.7 billion in overcharges, of which $2.7 billion is involved in bilateral contracts, some of which are FERC jurisdiction, some of which are not. OK. Then of the remaining $4 billion, about $900 million of that precedes October 2. Am I correct so far?

Mr. MADDEN. I think it is $1.8 billion before October 2.

Mr. HEBERT. That is correct.

Mr. MADDEN. And the $900 is non-jurisdictional.

Mr. OSE. OK. So you have got—of that $4 billion, you have got $900 million which is non-jurisdictional, which gets you down to $3.1 billion and that is for the period from say May 2000 through February 2001?

Mr. MADDEN. Through February 2001.

Mr. OSE. OK. So now you have got $3.1 billion you are looking at. And you are prevented by statute from going back prior to October 2, because that is the 60-day—the expiration of the 60-day period following the filing. And if you take out the numbers or the amounts prior to October 2, which is $1.8 billion, you end up with a universe of $1.3 billion.

And if I understood testimony yesterday, some of the questions which you have and which you are examining relate to how do you quantify the $1.3 billion. In other words, do you look at the month ahead contract versus the spot? Because yesterday's testimony was you came up on an annualized basis I think of $5 billion worth of overcharges attributable to the San Diego area only.

Mr. MADDEN. The $5 billion, Mr. Chairman, was associated with if San Diego had bought a year contract, based on its load, from the Duke contract offer. I do not know all the terms and conditions, at $55 a megawatt hour, versus what it would have to pay on the spot market in December-January, which is $345, you would have a differential of $5 billion they would have saved, just using that differential.

The testimony I gave yesterday with respect to the $1.3 billion is the ISO includes all hours, they say all hours are non-competitive, for the most part. We include an hour.

Mr. OSE. Thank you, Mr. Chairman.

Mr. BURTON. Let me just say that we have about 10 minutes maybe, at the most 15; is that right? So if we could stick close to the 5-minute rule so that he can leave. And if we have additional questions, we will go to Mr. Madden, he can stick around for awhile; is that correct, Mr. Madden?

Mr. MADDEN. Yes, Mr. Chairman.

Mr. BURTON. Let me see, Mr. Honda.

Mr. HONDA. Thank you, Mr. Chair.

A couple of quick questions. I heard you say that FERC has jurisdiction over 50 percent of the market more or less?

Mr. HEBERT. Roughly, yes.

Mr. HONDA. That is the retail or wholesale?

Mr. HEBERT. Wholesale.

Mr. HONDA. Wholesale.

Mr. HEBERT. We do not have retail jurisdiction.

Mr. HONDA. Statutorily do you have jurisdiction over the other percentages that does not appear under your control statutorily. If something is going wrong, something is being manipulated, do you have any responsibility in the name of protecting the consumers to look at the other percentages?

Mr. HEBERT. I do not have the legal authority or ability to do it.

Mr. HONDA. Next question, natural gas. It is said that gas imported from outside the State rises considerably. Have you found that to be unreasonable and unjust and have you found that to be part of the increase in cost that we are looking at and does FERC have jurisdiction over that?

Mr. HEBERT. I have got a pending issue on that. Yes, we have jurisdiction over those issues. I will tell you, as I shared earlier, there are concerns that we have got as well providing interstate capacity understanding there are intrastate constraints, takeaway capacity in the State. So hopefully, again, that is something else the CPUC can correct, but they are going to have to site some intrastate pipes, deal with some compression, to do that.

Mr. HONDA. Just very quickly, does FERC have responsibility or jurisdiction over looking at the possible price gouging from the increase in the gas prices here in California, coming from out of State? Because there have been some articles in the paper of possible manipulation of prices in that area too.

Mr. HEBERT. We have jurisdiction over the manipulation or over such conduct and it is pending hearing right now, so I cannot speak to it.

Mr. HONDA. Will your decisions and your assessment be shared with us by the time you have come up with the May report or May solution?

Mr. HEBERT. I am prohibited from giving you a time line on which—the May 1 I can share with you because it was in the order. This, which is subject to pending action, does not have a time line in it. I am acting expeditiously, I can assure you the Commission will act. I am prohibited from giving you a date.

Mr. HONDA. Is there a time line that you may share with us, more or less a soft date?

Mr. HEBERT. Protecting myself ethically and legally, and protecting the integrity of the Commission, I am prohibited from doing so.

Mr. HONDA. But we can expect something sometime in the future.

Mr. HEBERT. You have my word I am acting quickly.

Mr. HONDA. Thank you.

Mr. BURTON. Mr. Horn. Are you going to yield to Mr. Ose? OK, Mr. Ose, Mr. Horn is yielding to you.

Mr. OSE. Thank you, Mr. Chairman; thank you, Mr. Horn.

I want to go to the regional transmission organizations. I am trying to make sure I understand the timing of the request to all 50 States to submit their plans and the utility—or excuse me, the usefulness—I do not want to confuse it—the usefulness of the RTO proposals that you are supposed to be receiving. So specifically, could you tell me when FERC asked the various States to submit their proposals and for what purpose are you collecting that information?

Mr. HEBERT. We had two deadlines, the first being December 15, the second being—I am sorry—October 15 and the second being January 15, which is the one that California would have been subject to. One bit of correction, which I think I may have miscommunicated to you, there are two States, Alaska and Hawaii, of which we do not have that jurisdiction over.

Mr. OSE. Three total?

Mr. HEBERT. Well, Texas, if you include RCOT, correct.

Mr. OSE. Four total. How many States do you not have a regional transmission organization proposal from?

Mr. HEBERT. That we legally have the ability to get it from, one.

Mr. OSE. One, OK. Now the usefulness of the proposal is?

Mr. HEBERT. Understanding that we have natural markets, we are trying to set up competitive markets that work, that are functional. Good decisions, bad decisions that are made in California have good and bad effects in Washington and Oregon and Nevada. Understanding that, knowing that, California understands that, is committed to that. That is why, in fact, they talk about a Northwest price cap. That is why it is essential that we work together understanding that something like path 15 not only injures California and effects higher prices there when they do not repair it and move beyond it, it also affects others in the Northwest.

Mr. OSE. So your point is that because the sources of power are distributed across a multitude of States, of which they are selling at different times all into California or all out of California, we need to have some cooperation, if you will, or a meeting place where that sort of discussion can take place.

Mr. HEBERT. Right. When we were strictly looking at it in a monopolistic perspective, it was not an interstate commodity. When it is an interstate commodity, we have got to look at it in an interstate sense.

Mr. OSE. So we have Oregon's plan, we have Washington's plan, we have Idaho's plan, we have Wyoming's, Montana, Nevada, Arizona, New Mexico, Colorado. California? No, we do not have California.

Mr. HEBERT. No, sir, we do not.

Mr. OSE. Is that an impediment?

Mr. HEBERT. Yes, sir, it is.

Mr. OSE. Why?

Mr. HEBERT. Because we cannot move forward with our regional transmission organization, understanding that the West is one regional market.

Mr. OSE. How do we help you—I mean, can we do that at Congress, can we create that submittal?

Mr. HEBERT. It is a State action through the ISO. Obviously any direction that you, through your leadership, would give to them, I think they would take wisely.

Mr. OSE. I yield back to the gentleman from California.

Mr. BURTON. Let me see who is next. Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

Given the out-of-control prices in the Western region, especially here in California, I, like many, support at least temporary price controls—price caps actually—on electricity, natural gas and heating oil. Let me ask you though about your argument that these caps will discourage development since temporary price caps—I mean, how do they inhibit future investments when plants really would not be completed for 2 to 3 years, they have a generating lifetime and actual expected return on investment for decades? So I am curious about your argument with regard to that. How do you see that, in terms of wholesale price caps, as impeding development?

Mr. HEBERT. The decades of return based on some cost mechanism and variation of that, is something we have moved beyond, obviously. So they are not guaranteed anything for decades any more. That is yesterday's regulation, not today's.

The other part of that, as far as stimulating investment, we have certainly and a pretty valid conversation, I think, about that and what is being done with some of those dollars. We cannot force them to invest. What we can do is send proper signals, but the other side of that is again, what I continue to say, if you set a hard cap in place, you are telling the good people of California there is a price at which you are willing to turn the lights out. I am not willing to say that, or have not been convinced that is in our best interest, not to mention when the hard caps were in place and they moved the hard cap from $750 to $250 in California, the empirical evidence not only suggests but proves that average prices went up. And should that not be what this debate is about? Not what a single price spike is, but what the average price is.

Ms. LEE. But even—OK, what after soft cap then or a temporary soft cap? What—how does that——

Mr. HEBERT. Again, the Commission has moved in the direction of market mitigation so that we may try to mimic the market and move forward with it, and I think that is what we believe to be in the best interest and hopefully, you will see us move on something quickly with the May 1 timeframe in mind.

Ms. LEE. May 1, OK. Let me just ask you long-term, in terms of how you see the whole push now by some to require, say a 20 percent of the Nation's electricity to come from renewable sources by a certain year, say by the year 2020. I mean in terms of this crisis now, I think it provides us an opportunity to look at alternatives and we have not discussed long-term as much as I would like to, because we have got the immediate crisis that we have got to deal with. But what is your position or what does FERC think with regard to renewable energy sources?

Mr. HEBERT. I will tell you my persona position. As you, the Commission acts as one, we speak through our orders. We have made it very clear, in removing some impediments and obstacles with PURPA and others, that we think it is very important to do that. At the same time, I will tell you that California and the West is in a position where they need to add supply quickly and the quicker the better. I think it is very important to diversify, I think renewables has to be a part of that. I think it is important and that is what our orders have been about, removing obstacles and impediments, squeezing every megawatt out of this system that we can possibly do. We are committed to that. I think it is a wonderful idea.

Ms. LEE. Thank you very much, Mr. Chairman. Glad to hear you say that.

Mr. BURTON. I want to thank you very much for your candor today. There is one last question I would like to ask. There are environmental concerns about diesel-fired generators. We did have somebody to talk to me privately and I wanted to ask your opinion, even though this may not be in your jurisdiction, and that was that they said to get California over the hump this summer, that there could be brought into the State temporarily on barges and on trucks and so forth diesel-fired generators that could create the capacity to get the State over the hump without rolling blackouts. Do you have an opinion on that?

Mr. HEBERT. My opinion would be that darkness, the lights going out, is absolutely the worse thing that could happen. Whatever you can do to prevent that, I think is good. I think demand side is very important, but at the end of the day, you had better have adequate supply. Historically, California has not been willing to do much with diesel generation. If you will remember right, and I know you do, they brought barges up through the Canal Zone and actually into San Francisco Bay when they feared a blackout and they turned them around and sent them back since they were diesel generators.

I have also had meetings with producers who were flaring natural gas, who informed me that there is about 1,000 megawatts of production right there that they could put on line if they were allowed to do it.

There are lots of opportunities here. The conversations need to stop, someone needs to start putting shovels in the ground, someone needs to start hooking up some type of generators to provide the electricity so the people will not be in danger this summer.

Mr. BURTON. Thank you very much.

Mr. HEBERT. Thank you.

Mr. BURTON. We appreciate you being here. I hope you make your plane.

Mr. HEBERT. I will submit this to the reporter, is that is all right, Mr. Chairman.

Mr. BURTON. That will be fine, we will accept that without object and put it into the record.

Mr. HEBERT. Thank you. And if I may tell the public, the one question that the public had asked is on rehearing. We cannot speak to it. If Congressman Honda would like for us to give him what we can, we will be glad to do that. It is on rehearing, and I am going to a hearing right now, as you know. I am not trying to escape anything, but thank you for having us and shedding light.

Mr. BURTON. Thank you. Thank you, Mr. Madden, as well. I think we have concluded with your total panel and we appreciate your help.

The next panel—do you want to take a break? Why do we not take a 10-minute break and then we will go to the next panel, 10 minutes.

[Recess.]

Mr. BURTON. If we could get everyone to take their seats, I understand that the media is anxious to talk to a number of members of the panel and others, but we really need to get started.

Our next panel consists of Ms. Dede Hapner, vice president of regulatory relations for Pacific Gas and Electric; Stephen Pickett, who is the vice president and general counsel of Southern California Edison; Mr. Dean Vanech—is that correct—president of Delta

Power Co.; and Mr. Paul Desrochers—how do you pronounce it, like Leo Desrocher? OK, I will not forget that one—Mr. Paul E. Desrochers, director of fuel procurement for Thermo Ecotek.

Would you please stand?

[Witnesses sworn.]

Mr. BURTON. Being a gentleman, we will start with Ms. Dede Hapner and let her make an opening statement.

STATEMENTS OF DEDE HAPNER, VICE PRESIDENT, REGULATORY RELATIONS, PACIFIC GAS & ELECTRIC; STEPHEN PICKETT, VICE PRESIDENT AND GENERAL COUNSEL, SOUTHERN CALIFORNIA EDISON; DEAN VANECH, PRESIDENT, DELTA POWER CO.; AND PAUL DESROCHERS, DIRECTOR OF FUEL PROCUREMENT, THERMO ECOTEK

Ms. HAPNER. Thank you very much, Mr. Chairman, and members of the committee and guests to the committee. My name is Dede Hapner, I am vice president of regulatory relations for Pacific Gas & Electric Co., that is the regulated utility. And I appreciate the opportunity to speak before you today.

Clearly, this hearing comes at a very opportune time. You have heard both yesterday and today about the prices that we have in the West. In March, for example, the average wholesale price was approximately $307 per megawatt hour and there is no relief in sight.

At this point, we are even more concerned about the megawatt shortages because there is less hydropower in the California system and in the entire Northwest than we traditionally have, about 60 percent of normal, at least based on the last snow pack results.

In the first several months of this year, the California Independent System Operator has declared 52 stage two electric power emergencies and 36 stage three electric power emergencies. Residents of California had no idea what stages one, two and three meant 6 months ago, and now that is as common as hearing about the traffic report.

At best—and I believe you heard from Mr. Winter yesterday—we will be short several thousand megawatts this summer and that is at best.

The utilities, including Pacific Gas & Electric Co., first raised the issue of shortages and the gap between wholesale power costs last summer. We have been working with the State officials to try and address these issues, but unfortunately the activity that we have seen so far, while it has most assuredly meant progress, has still been on a very incremental basis and not in a comprehensive form.

Earlier this year, the State legislature passed and the Governor signed AB–1x, which we looked forward to as a way of stopping the bleeding with respect to the amount we were paying in wholesale power costs. The State authorized the Department of Water Resources, which had some experience in the electricity market, to enter into contracts and purchase electricity on behalf of the customers of California's investor-owned utilities. We were pleased because we thought that bill required the Department of Water Resources to buy the entire net open position of the utilities and that would be the amount that we would have to buy on behalf of our customers that was not generated by our hydro system, for example, or Diablo Canyon or our qualifying facility contracts.

Unfortunately, that has not proved to be the case. The Department of Water Resources has signed many, many contracts, but they still have to buy on the daily market and in real time and because of the price constraints that they have set for themselves, there is still a gap. And so in real time, the Independent System Operator, in order to keep the lights on, buys power in the very expensive spot market and the utilities have been billed for those power costs. So clearly, our net open position is not being covered by the law, as it currently stands.

You have also heard from President Lynch on the California Public Utilities Commission that they have moved very swiftly and adopted several orders to ease the situation, including a series of rate increases or, as they are termed to avoid the implication that the rate freeze is actually over, surcharges.

Again, that would seem to help the financial situation for the utilities. In reality, however, the 1 cent surcharge and the 3 cent surcharge that the Public Utilities Commission passed through over the last several months will not do anything for the billions of dollars of uncollected power costs that the utilities have already incurred, and perhaps even more importantly, once Pacific Gas & Electric Co. pays the required amounts to the Department of Water Resources for the power that they are buying on behalf of our customers, pays our qualifying facilities as per our contracts, pays for our own generation, there frankly just is not any money left. In fact, it is very doubtful, and we have testified at the Public Utilities Commission, that there is a negative amount, even looking at that 4 cents.

Mr. BURTON. Ms. Hapner, we try to stay with 5 minutes.

Ms. HAPNER. I am sorry, I apologize.

Mr. BURTON. If you have just a little bit more, please go on.

Ms. HAPNER. I will wrap up.

Basically, we are now in a situation, as the committee well knows, where our utility has sought protection of the Bankruptcy Court, in hopes of finding a comprehensive solution. What we would like to ask the committee to consider today is some short-term steps that will help California through this next summer. Particularly, we would like to see the committee recommend to the Secretary of Energy or to the FERC that there be short-term price caps to help stabilize the situation and then anything that the committee can do to move regional transmission organizations forward and look at the situation of the entire West with respect to renewables would be very much appreciated.

Thank you.

Mr. BURTON. Mr. Pickett.

[The prepared statement of Ms. Hapner follows:]

TESTIMONY OF DEDE HAPNER
Vice President – Regulatory Relations

PACIFIC GAS AND ELECTRIC COMPANY

BEFORE THE COMMITTEE ON GOVERNMENT REFORM

APRIL 11, 2001

Executive Summary

- Wholesale electricity prices in California and the West remain at unprecedented high levels.
- Supply, both in terms of available megawatts and the natural gas and hydro resources needed to produce electricity, is extremely tight.
- Based on what we know today, due to short supplies the price of power could be headed toward even more astronomic levels this summer.
- California's market structure, which required utilities to divest their power plants and to purchase power on the volatile spot market, and shielded consumers from price signals, has not served the state well under these short supply conditions.
- Recent legislative and regulatory actions taken by the state do not provide a complete remedy for some of the problems they were intended to address.
- Even doing everything we can immediately to increase supply and decrease demand will not adequately mitigate the potential economic impact this summer when electricity usage is at its highest levels.
- Accordingly, we have concluded that authority to impose temporary, limited wholesale price caps for the western energy market must be provided in this extraordinary situation.
- While state officials and stakeholders in California are urgently working to craft a resolution to this crisis, the federal government should also act to:
    - moderate prices for the summer;
    - encourage Regional Transmission Organizations and truly open access transmission systems;
    - accelerate permitting of natural gas pipelines;
    - streamline federal agency review and approval of energy infrastructure projects;
    - encourage efficient use of electricity through research and efficiency standards;
    - encourage continued development of renewable energy resources by maintaining the existing renewables production tax credit; and
    - increase funding for low-income energy assistance to help assure that those least able to pay are not left without access to reliable energy.

Introduction. Good morning Mr. Chairman, and members of the committee. I am Dede Hapner, Vice President of Regulatory Relations for Pacific Gas and Electric Company.[1] Thank you for the opportunity to testify before you today, as you examine California's electricity shortages and related price impacts across the West.

This hearing comes at an opportune time, as we prepare for the summer months here in California. Let me share with you what our current situation is; how we got here; and what in our view needs to be done, both in the short and longer term, to resolve this crisis.

Where are we? As you know, wholesale electricity prices in California and the West remain at unprecedented levels -- the estimated average wholesale price for March in California was $307 per megawatt hour, with no relief in sight. Supply, both in terms of available megawatts and the natural gas used to produce electricity, is extraordinarily tight. Hydropower, in particular, continues to be in short supply. At this point, moreover, it appears certain that the availability of hydropower across California and the Pacific Northwest will be substantially below normal. The latest snow pack monitoring showed that the state is at 60 percent of normal and we currently forecast our hydro availability at about 70 percent of normal, while BPA continues to forecast hydro at around 60 percent of normal.

In the first several months of this year, the California Independent System Operator (ISO) has declared 52 Stage 2 electric power emergencies and 36 Stage 3 emergencies. Announcements of the power emergencies have become as common as the traffic reports. As we look to the peak usage summer season, the predictions are dire. At best, according to the California ISO, the state will be short up to 3,600 megawatts for the summer, and that forecast may not fully reflect current hydro conditions in the Northwest.

The utilities first made the state aware that we were headed for a crisis last summer. State officials have been working to address these issues, but have done so in a piecemeal and incomplete fashion. I'll discuss briefly some of the recent state legislative and regulatory actions and why we don't think they yet provide a complete remedy for some of the problems they were intended to address.

Earlier this year, the state legislature passed and the Governor signed into law Assembly Bill (AB) 1x, which authorized the state Department of Water Resources (DWR) to enter into contracts to purchase electricity on behalf of the customers of the financially strapped utilities. Although the law states that DWR

[1] Pacific Gas and Electric Company, a subsidiary of PG&E Corporation, is an investor-owned utility company providing electric power service in a 70,000 square mile service territory in Northern and Central California, with a population of 13 million, about one in 20 Americans.

is to purchase what is referred to as "net short electricity" -- the amount that is needed to fulfill customers' demand that can not be met by the generation owned or under contract to the utilities -- it is now not clear whether DWR is buying all of the net short electricity that is required, or just a portion of it. Assuming DWR is not purchasing the full amount, the California ISO is left to purchase the remaining amount needed on the spot market at market prices; the ISO then bills the utilities for the electricity purchased. Therefore, although the intent of AB 1x was to remove the utilities from the position of buying electricity, implementation of the law does not appear to have ensured that result.

You are also likely aware that the California Public Utilities Commission (CPUC) adopted several orders, including an electric power rate increase, late last month. Although it may seem that a rate increase would be beneficial to the utilities, the orders established that the increase is to be used to pay, on a going forward basis, the electric power procurement costs of DWR, the Qualifying Facilities (QFs) and the California ISO. The CPUC took no action, however, to enable the utilities to be repaid for their prior uncollected power costs and expressly prohibited the use of the newly ordered incremental revenues for that purpose. Therefore, the order does not guarantee that there will be sufficient revenue to cover all generation needs for the utilities. The CPUC also adopted new accounting procedures that change accounting rules that have been in place since 1998, retroactively restating and redirecting amounts that had been applied toward power purchases and the repayment of our transition costs. The net impact of these orders will have negative consequences for the financial health of the utilities unless the orders are rescinded, stayed, modified or superseded, either by legal action or through a settlement with the state.

It is not just the utilities whose financial health is suffering. Prior to the CPUC's recent order, Pacific Gas and Electric was paying the QFs the portion of their charges provided for in rates -- about 15 cents on the dollar. The QFs are still owed millions of dollars for the electricity they sold into the grid. Ultimately, California needs the generation the QFs can provide and the QFs need credit-worthy utilities to which they can sell their power.

Other utility creditors are suffering as well. Holders of the utilities' commercial paper have not been repaid when those debts have come due. The affected entities that hold these investments include cities, counties and retirement funds.

How did we get here? California's problem is fundamentally one of supply and demand: statewide, between 1996 and 1999 electricity demand grew by 5,500 MW, while supply grew by only 672 MW. Reduced hydropower supplies and rapid economic and population growth have exacerbated the effects of this extreme imbalance between supply and demand across the West.

In addition, higher natural gas prices across the nation are contributing to higher electricity prices.

The problems in California are not the result of the overall concept of opening electricity markets to competition. Basic economics tells us that under any regulatory system, wholesale power costs would be substantially higher under the conditions I have just described. That said, it is true that California's approach to electricity restructuring, combined with short power supplies, have undoubtedly led to the unexpected 500 to 1,000 percent wholesale power cost increases experienced over the last eight months and to the resulting financial crisis for the utilities.

California's restructuring approach required utilities to divest their power plants and to purchase all of the power needed to serve their customers on the volatile spot market. Further, despite repeated requests to the CPUC, the use of long-term bilateral contracts or other price "hedging" devices – standard financial tools utilized by companies in this and many other industries to protect against price fluctuations -- were also precluded. In August 2000, the CPUC approved our request to hedge in the bilateral market, subject to agreement on implementation details with staff of the CPUC. Although PG&E made proposals and held numerous discussions with the staff, staff neither agreed to key contracting terms -- the so-called "reasonableness standards" -- nor offered any alternatives. To this day, reasonableness standards have not been established by the CPUC staff. Thus, our ability to protect ourselves from price fluctuations in this standard and practical way has been thwarted.

In addition, frozen retail customer prices have shielded consumers from the real costs of electricity, nearly eliminating price signals to make energy efficiency investments or to conserve, and thus reduce demand. The recent rate increase approved by the CPUC, discussed above, does provide some additional incentive to reduce demand, but it does not come close to sending true market signals.

Where do we go from here? California's energy crisis cannot be resolved until supply and demand are back in balance. To increase supply, new clean and efficient power plants must be sited and built, together with natural gas transmission and distribution pipelines and high voltage power transmission lines. To reduce demand, energy efficiency investments need to be made[2] and customers need to see accurate price signals. Over time, with infrastructure investments and wise public policy, supply and demand can be brought into balance, market forces will prevail, and wholesale prices should return to appropriate levels.

[2] Pacific Gas and Electric Company has long been a leader in energy efficiency. The Company was honored to receive from the Department of Energy and Environmental Protection Agency the Energy Star award for "Excellence in Consumer Education" last month.

In the very short-term, however, we anticipate major problems this summer. The summer challenge is to somehow moderate or limit electricity price impacts – while simultaneously sending the correct market signals to promote supply-demand equilibrium. California and the West will be scrambling to use all tools currently available to address the problem. In California, that means 1) bringing power plants not currently operating back on line; 2) siting and building additional "peaking" power plants in an expeditious manner; and 3) implementing emergency demand reduction efforts. All three of these measures are the best mechanisms available to address the very top of the demand peaks that will occur -- and to help mitigate prices without exacerbating the supply problem.

At Pacific Gas and Electric Company, we have several teams of employees addressing Summer 2001 projects on an emergency basis. On the demand side of the equation, these efforts include an extensive public outreach program to encourage conservation and implementation of energy efficiency programs that include rebates for new appliances. We are also implementing load management programs for our commercial and industrial customers. To address supply, sites have been identified and made available for peaking units to be installed to meet the summer peak. In short, we are acting immediately to provide market-oriented solutions that attack the supply-demand imbalance with fast-track initiatives and projects.

Even with our extensive efforts, however, given the extent of the expected supply-demand imbalance for this summer, it is not clear that these tools will either fully mitigate the supply shortages or the potential economic impact that may result. To address the economic impact, we have considered legislation that addresses temporary price caps in one way or another.

Historically, PG&E Corporation has not supported price caps; over the long term, they create market distortions and have unanticipated and unintended consequences. In a functioning market, they mask the peak price signals that spur conservation, changes in usage patterns, and investment in energy efficiency and new supply. Thus, price caps often make matters worse.

That said, almost a year ago we recognized that in circumstances where power markets are not fully competitive, short-term implementation of price caps or a similar market mechanism might be necessary. Therefore, we adopted a corporate policy statement (attached) that addressed those circumstances, which can be summarized as follows: where markets are clearly broken -- for example, where the Federal Energy Regulatory Commission (FERC) has determined that prices are not "just and reasonable" – some sort of short-term intervention in the market may be warranted.

Specifically, where FERC has found that rates are not just and reasonable, as they did in California, policy makers should create a mechanism that would allow either the Secretary of Energy or the FERC to implement temporary price caps. It seems only prudent to create the policy tool and carefully define the circumstances under which that tool can be used, including the duration of use. For example, any price cap should have an explicit start and sunset date, for instance, May 1st and September 30th of this year. And in order not to discourage inadvertently new, badly needed power plants, the price cap should apply only to existing generation.

With respect to setting a price cap, it must be simple enough to be easily administered, and it should allow suppliers to make a reasonable profit. Interestingly, recent press reports suggest that even one major generator that sells electric power into California may be inclined to support some type of wholesale price cap.

What can be done now? A comprehensive solution is required that will assure reliability and public safety, stabilize retail rates to customers, address the longer-term infrastructure needs while protecting California's environment, and return the State's utilities to financial health. These efforts are of paramount importance.

Beyond the necessary state actions, the federal government should also do everything it can. Specifically, we believe the federal government should:

- moderate prices for the summer;
- encourage Regional Transmission Organizations and truly open access transmission systems;
- accelerate permitting of natural gas pipelines;
- streamline federal agency review and approval of energy infrastructure projects;
- encourage efficient use of electricity through research and efficiency standards;
- encourage continued development of renewable energy resources by maintaining the existing renewable production tax credit; and
- increase funding for low-income energy assistance to help assure that those least able to pay are not left without access to reliable energy.

Thank you for the opportunity to appear before you. I would be happy to answer any questions you might have.

Mr. PICKETT. Thank you, Mr. Chairman, members of the committee. I am Steve Pickett, I am vice president and general counsel of Southern California Edison and I hope you forgive my scratchy voice, I have a cold today unfortunately.

We are very pleased at Edison that over the last few months, both the State and the Federal Government have begun to move to solve this crisis. We do have a crisis and it is time to roll up our sleeves and start solving the crisis in practical ways that can be implemented quickly.

Let us make no mistake, many of the problems are of California's making and many of them are California's to fix. And that does not include just the State government, but it includes the utilities as well. There is no question but what the utilities were slow off the mark in recognizing the impacts of the dramatic load growth brought about by the booming economy and were undoubtedly too slow in sounding the alarm of the impending crisis.

The State government, for its part, did clearly adopt in the deregulation process in California, a very flawed market structure. FERC approved it and I think in good faith, the State Government and the utilities in California expected FERC to be on the job monitoring that market in a more aggressive way than it has done, but clearly the market structure is a California problem.

The California utilities were prevented from entering into long-term contracts to solve the problem until it was way too late for them to do so. And most fundamentally, the State government was way, way, way too slow in recognizing the basic business fundamental that retail prices have to match wholesale costs or the utilities will be driven into bankruptcy.

In recent weeks and months, we have seen some action in California, the California Commission, as Ms. Hapner said, has raised rates 10 percent approximately in January, another 30 percent in March, a very difficult and traumatic decision for the State. And I am very pleased to say that last Monday, my company, Edison, and representatives of the Governor of California entered into a memorandum of understanding that we think provides a framework and a comprehensive plan for helping us resolve the crisis for us and for our customers, allow our company to return to a creditworthy status that will allow us to continue providing quality service to our customers.

Many, many, many hurdles remain to implementing that MOU, but it is a very positive first step and we are pleased that we have been able to take it.

FERC has begun to act as well, Unfortunately I believe not nearly as aggressively as they should have done. The San Diego complaint that brought the matter first to FERC's attention was filed in August of last year and the final rehearing is not out on that yet, so that we can get the matter before the court. We believe the FERC has taken an unduly narrow view of their jurisdiction there. There is a 65-year old statute and a host of regulations, the Federal Power Act and a host of regulations under it, that are well-established law, that are designed and were adopted in the depression era to prevent exactly what is happening in California today, and that is the abuse of customers, who have essentially no choice in the price of power that they have to pay.

In November, the FERC did find that the wholesale rates being charged in California were not just and reasonable. I think Commissioner Hebert's reading of that order, as he presented it today, was unfortunately unduly narrow. The FERC did find that the wholesale rates were not just and reasonable and yet they have allowed them to continue to be charged.

In the face of evidence that the market is dysfunctional, evidence by the way that the FERC has never held an evidentiary hearing upon, they eliminated the ISO's market caps back in November and December, and the predictable happened, the market exploded. At a time of low load when prices should be down, where there is plenty of supply available, the market exploded.

Now some have argued that price caps are antithetical to efficient, effective, competitive markets and would disincent new supply. I am not an economist, I am not here to argue about the efficacy of those views today, but I am here to say that we do have a crisis. And this is not a time for ideology at any regulatory agency, State or Federal. It is a time for practicality, it is a time for common sense and it is a time to protect the public interest.

It is the public interest that only the FERC under the statute can protect. They have the authority, the only authority, over the wholesale markets.

Two quick points, I see I am out of time, I will wrap up quickly. One is that this is not entirely a supply and demand problem. There is no question that supply is tight, we do have a need for new supply, and in the summer months, the few peak hours in California, we have a potential supply problem—no question.

But the blackouts in January and again in March were not a function of that supply problem. In March—when the blackouts occurred in March, there were 14,000 megawatts of capacity idle. Some of that may be due to legitimate problems and maintenance, clearly not all of it. That is not a supply problem, that is a market function problem, one that has to be corrected.

And let me just close by suggesting what I believe needs to be done quickly and I would urge this committee and the Congress to urge the FERC to do; and that is, we need to call a time out. We need to say stop, this is crazy. We need to temporarily return to a system that we know that works. Maybe it is a system that had problems, everybody would acknowledge that, but we know that cost-based ratemaking works. It is embodied in the law, it is embodied in the FERC's regulations, it is the norm. Market-based ratemaking is the exception, it is only supposed to exist when there are workably competitive markets. We do not have that. We need to temporarily return to the regulated, cost-based system which provides a fair return to the generators, it imposes an obligation to serve, so we will not have 14,000 megawatts off line while people are sitting in the dark and if need be, we can look at exceptions to that rule for new generation, so that we can clearly incent supply.

But let us take a time out here, let us fix this market. I happen to believe and my company believes that markets are the right way to go. They allocate capital for new generation projects more efficiently than the regulated system did, but the market has to be set up to work and we cannot sit here with a failed market and allow customers to be gouged.

Thank you.

Mr. BURTON. Thank you, Mr. Pickett.

Mr. Vanech.

[The prepared statement of Mr. Pickett follows:]

Testimony of

Stephen E. Pickett
Vice President and General Counsel
Southern California Edison

Before the
U.S. House Committee on Government Reform

April 11, 2001

Good morning Mr. Chairman and Members of the Committee. I am Stephen E. Pickett, Vice President and General Counsel of Southern California Edison. I appreciate the opportunity to testify before you on the crisis in electricity supply and prices now affecting California and the Western United States. This crisis threatens both the reliability of the Western power grid and the economic well being of California and potentially the entire country. It has captured the attention of the Nation and we must work together to solve it. California cannot simply solve this problem on its own as some have alleged. It is the federal government, more specifically FERC, that deregulated the wholesale market, not California, and only FERC can fix that broken market.

Before this crisis began less than a year ago, my company was financially healthy. Our credit rating was A+ and our market capitalization was approximately $6.5 billion, based on a share price of $20. Today, our credit rating is deeply speculative grade or "junk". Our stock price has dropped to a low of $6.25, but has fluctuated over the last few weeks between $11 and $15. If FERC and the California PUC had done their jobs, this would not have happened, and we would not be here today. Unfortunately, over the last ten months, it has become very clear that neither of these entities was prepared to manage the competitive wholesale generation and restructured retail markets that they are charged to administer in the public interest.

Through January 2001, and to reliably serve its customers, Southern California Edison incurred $5.5 billion more for power than it was allowed to collect through retail rates. We financed this shortfall by borrowing staggering sums of money until we exhausted all available credit. To conserve cash in order to maintain customer service, we suspended payment of certain obligations. As of the middle of March 2001, we had unpaid and overdue debt payments of $729 million in principal and interest. Edison owes an additional $1.9 billion in power procurement costs. We eliminated common dividend payments for both the Fourth Quarter of 2000 and the First Quarter of 2001 -- the first time in our 100-year history. And we have implemented, or sought to implement, major cost reductions including layoffs and reductions in capital expenditures.

Because of astronomical wholesale electricity prices, the retail rate freeze, and the unavailability of credit, our power procurement responsibilities were transferred to the California Department of Water Resources in late January 2001. While this action significantly stanched the bleeding of our financial resources, this placed unprecedented financial demands on the state of California. To date, the state has accumulated nearly $4 billion in power procurement costs and is spending anywhere from $45 million to $60 million each day for electricity. Although the state is attempting to reduce its reliance on the spot market by entering into long-term contracts with sellers, this has been a difficult task because prices for the near-term remain extraordinarily high in the West.

Over the last ten months, California has seen wholesale electricity prices skyrocket. In 2000, California paid $28 billion for electricity -- $21 billion more than the $7 billion it paid the year before. However, these costs pale in comparison to the projections by the Market Surveillance Committee of the California ISO which estimates 2001 electricity costs to be $70 billion!

As staggering as these increases are, the high prices that California has been paying have not assured adequate supply. Power emergencies are an everyday occurrence, even during a time of relatively low customer demand. Rotating blackouts occurred in Northern California on January 17 and 18 and were repeated in Southern

California on March 19 and 20. And these blackouts occurred while more than 14,000 MW of generation capacity sat idle.

There have been many reasons offered for this shortage of capacity -- the credit problems of the utilities, the deliberate withholding of generation by sellers, transmission constraints, breakdowns of generating units, and the need to perform scheduled maintenance. I suspect that there's an element of truth to each of these claims, but only the FERC knows, or should know, for sure. And why is this? Because it is the FERC that granted market-based rate authority to the entities that purchased the generation divested by California utilities like mine. It is the FERC that granted power marketing licenses to the scores of power marketers that have profited from buying and reselling power in California. And, it is the FERC that collected quarterly reports from these marketers and has the ability to collect data from all the California market participants as part of its obligation to maintain just and reasonable wholesale rates.

To be sure, California is far from blameless in this crisis. The market structure implemented by California is terribly flawed, despite the best intentions to introduce competition and lower prices for consumers. The CPUC failed to allow forward contracting, prevented retail price increases that would have sent proper price signals to encourage conservation, and provided no assurance that we would ultimately be able to recover our massive undercollections in wholesale power procurement costs (which amount to $5.5 billion as of January 31, 2001). My company and the other California investor-owned utilities failed to anticipate the looming imbalance between growing customer demand and available generation supply. The generators and marketers clearly have taken advantage of the dysfunctional power market and appear (as reported to FERC by the California ISO) to have engaged in both economic and physical withholding of generation capacity thereby driving electricity prices above competitive levels.

The FERC, however, has failed to stop sellers from taking advantage of the broken wholesale market, despite finding as early as last November 1 that the wholesale market was indeed dysfunctional, that sellers had the opportunity to exercise market power, and that prices were "unjust and unreasonable". Just last month, after months of complaints and literally thousands of pages of pleadings, reports, and evidence establishing that sellers in the market were exercising market power, FERC at long last issued two orders that *might* require 13 power sellers to refund \$69 million and \$55 million for sales in January and February 2001, respectively. Even if FERC actually orders such refunds, this would be less than three days of state spending for electricity over the two-month period. For the reasons articulated well by Commissioner Massey in his dissent to these orders, this action utterly fails to protect consumers from unjust and unreasonable wholesale rates.

So where do we go from here? What needs to be done? I cannot overemphasize that any effective solution to the Western energy crisis must involve not only the State of California, but the federal government as well. Given the potential impact on the economies of California and the West, it is dangerous for the Administration or the Congress to conclude that California should simply solve the problem itself. The federal government, through the Federal Energy Regulatory Commission, can only address wholesale price gouging.

The need for swift and effective federal action is urgent. The Market Surveillance Committee of the California ISO has now estimated that wholesale electricity prices in

California may grow from $7 billion in 1999 to $70 billion in 2001, a ten-fold increase. Even if it turns out that Cal ISO's estimate is only half right, the impact on the economies of California and the West will be devastating. The consumer backlash, when the bills arrive, will be deafening.

What should the state be doing? The state should be encouraging the construction of additional generation supply, the expansion and upgrade of transmission infrastructure, and the construction of intrastate gas pipeline capacity. They should allow for retail rate increases that will enable the recovery of past and going forward procurement costs of wholesale electricity. This is essential to restore the financial health of the investor-owned utilities and to restore the confidence of the investment community so that capital will be available to build much-needed transmission and distribution infrastructure in the future. The state must also encourage consumers to significantly reduce consumption during the next two years when generation shortages are expected to be most acute.

The state has been taking many of the actions that I described above. Over the last 12 months, the California Energy Commission has approved the construction of nine generating facilities, amounting to 5,477 MW. 13 more power plants with generating capacity of 6,187 MW are in the pipeline. The process for obtaining approvals to construct a generating facility in the state has been reduced to six months and financial incentives have been offered to obtain peaking capacity this summer. The state has also allocated $800 million to buy-down customer demand and to create incentives for the installation of energy-efficient lighting and demand side management. The Southern California Air Quality District has also taken actions designed to ensure that compliance with Nox requirements do not result in plant shutdowns or excessive costs. The state has also begun to increase retail rates to align them with the price of electricity on the wholesale market, although these efforts have not been sufficient to date to prevent further deterioration in the financial condition of this company. Clearly, the state is taking action. It is imperative that the federal government takes action as well.

What should the federal government be doing? The single most important thing is for FERC to do its job. Section 205 of the Federal Power Act requires FERC to maintain just and reasonable wholesale electricity rates. In order to do this, FERC must do three things:

First, FERC must temporarily revoke the authority granted to all sellers of electricity in the Western energy market to sell at market based rates. By any measure, current wholesale electricity prices resulting from the dysfunctional market cannot be justified as "just and reasonable". As a result, sellers' market-based rate authority is illegal and should be eliminated. The revocation of market-based rate authority should remain in effect until a workably competitive market exists. For example, market based rate authority could be reinstated once a specified level of reserve margins is in place in the Western electricity market.

Second, FERC should impose temporary cost-of-service based rates, along with availability requirements, for all sellers in the Western electricity market. These cost-of-service based rates should be applicable to all sellers, regardless of ownership. Under this approach, sellers would be entitled to full recovery of their costs of owning, operating, and maintaining their generation assets, including a return on invested capital. In order to avoid creating a disincentive to the construction of additional generating supply, new generation would qualify for market based rates, and would not be subject to cost-of-service rates. Thus, incentives would exist for the construction of additional supply. Cost-of-service based rates should be temporary and be eliminated once specific generation supply goals are met and FERC has found Western wholesale electricity markets to be workably competitive.

As you're probably aware, Energy Secretary Abraham has made known his and the Administration's opposition to "price caps" in the Western market. The rationale for their opposition is that they will eliminate construction of new generation supply and lead to more blackouts this summer. I respectfully disagree. First, exempting new generation, as the Feinstein-Smith proposed legislation would do, will eliminate rate regulation-based disincentives to the construction of additional generating capacity. Second, the implementation of price caps will likely result in fewer blackouts, not more. As the Cal ISO has found, the withholding of generating capacity is a strategy used by sellers to create artificial shortages (possibly leading to blackouts) and increasing market prices. This incentive for withholding would be eliminated by imposition of a cost-of-service based cap since withholding would no longer drive increases in wholesale electricity prices.

The third action FERC should take is to order sellers to refund overcharges incurred during the May 2000 through February 2001 period. The California ISO has compiled significant evidence that generators have exercised market power through the economic and physical withholding of generation capacity. In particular, Cal ISO found that such withholding resulted in increased wholesale electricity costs of $6.2 billion since May 2000. FERC should promptly examine this evidence and order refunds of these overcharges.

In conclusion, I would like to thank the Committee and you, Chairman Burton, for holding this hearing. We are working hard in California to develop and implement long-term solutions to the problems in California's electricity market. But we cannot do it alone. We need FERC to do its job to ensure that the promise of reliable and affordably priced electricity is available to all citizens of California and the West. Nothing short of the well being of our citizens, our economy, and the future of competitive electricity markets is at stake.

Mr. VANECH. Thank you, Mr. Chairman, committee, I appreciate the opportunity to discuss the views of gas-fired QF cogenerators in the State.

Just for some background, since the passage of PURPA in 1978, California has been a leader in developing QF facilities, by far more than any other State. In fact, now it amounts to nearly one-third of the supply to the IOUs. In numbers, that means about 10,000 megawatts of QFs are on line and about 5,400 or roughly 60 percent of those QFs are natural gas-fired. Of the 5,400 or so megawatts, we understand about 3,000 are actually off line right now, and given the system-wide load of about 30,000 megawatts, that is obviously significant.

Going back a bit and almost since the inception of PURPA and the time these projects came on line, there has been from time to time, more often than not, a contentious relationship between the QFs and the regulated utilities. And in my view, there is at least three reasons why that is.

No. 1, when QFs build plants, the utilities lose rate base and when they don't have rate base, they earn less profits since they make a profit off of their assets.

No. 2, I think there is a general concern about loss of control.

And third, a fear that QF power is more costly than otherwise available power that the utilities can actually construct.

QFs have provided significant benefits to the State, including an increase in system reliability by scattering generation rather than having fewer plants, typically away from the load center. There have been ancillary benefits to the transmission and distribution network. California's manufacturers and institutions have saved hundreds of millions of dollars, if not more, in the way of competitively or low-cost thermal energy that is typically heat wasted in a conventional power plant. That steam or other energy is used in manufacturing and replaces the cost of production, or lowers the cost of production for those manufacturers.

Also, QFs have used new and clean technologies. Most of these plants are less than 15 years old and have adhered to more stringent permitting requirements.

The QFs are often compared to otherwise available sources of supply for the utilities. QFs by nature are long-term in respect to their agreements, and from time to time, there clearly have been imbalances between the cost of QF power and the cost of otherwise available power over the short term. And in fact, during certain periods and during certain years, QF power, as compared to the otherwise available spot market cost of power, has in fact been more expensive.

But there is another side to that equation. We calculate, based on our consultants, that in year 2000 alone, Edison saved somewhere around $800 million by buying QF power as opposed to spot market power. We think that PG&E has probably realized similar savings. In fact, the monthly cost, additional cost, of the QFs being down now, around 300 megawatts—I will just speak to the gas-fired QFs that are shut down—are probably costing the State somewhere between $200 and $300 million a month in additional cost because that power has to be brought in from other sources that are much higher priced than the QF contracts.

Why the QFs are not operating today—and again, I will narrow my discussion on the gas-fired QFs. As has been well publicized, the QFs have not been getting paid by the utilities and that is widely known. As a result, and particularly acute for gas-fired projects, we cannot pay our fuel suppliers and they will not sell us fuel any more. These projects are typically financed on a stand-alone basis so it is not as though there is an enormous balance sheet that can just keep funding these losses. These projects have to be able to pay their bills.

In addition, the current and recent formula or the order passed by the Public Utility Commission substantially modified the way QFs get paid and it is particularly problematic for gas-fired projects.

There are two major changes that were made to the formula. One was the efficiency rate used in the formula was lowered significantly from around 10,100 to 9,100. That results in lower revenues.

And the second major issue is the Topock Index, which is the southern California Gas Index, was substituted with the northern California Gas Index, known as Malin. The problem is there is about a $5 difference in the cost differential between Malin and Topock. This issue is the QF cogenerator, gas-fired cogenerator, has to buy gas at Topock, but in the revenue formula only gets the benefit of the Malin price. So therefore—and just for quick numbers; if today, the Topock gas price results in a cost to produce of about $140 per megawatt hour, the new revenue formula passed by the Utility Commission pays us somewhere around $8 or $9, perhaps a little less. In other words, even on margin, there is about a $50 per megawatt hour loss on generation. That is why it is impossible for the QFs, the gas-fired particularly, to stay in business.

I will try to finish quickly.

I just wanted to quickly discuss what we think needs to be done because these projects need to come back on line, particularly given the acute shortage of power in the State.

No. 1, until there is liquidity in the market and until the investor-owned utilities can pay their bills, we need the right to be able to sell outside of our contracts. And that does not necessarily mean they terminate, it just means that we have the right to be able to sell to other parties in order to get liquidity in our projects, to avoid the projects themselves going bankrupt.

The other issue is, and it is perhaps a lessor issue, these projects are paid both a fixed and a variable charge, known as capacity payments, the fixed charge. The utilities must continue to pay the fixed charges even though certain plants have been down, because of non-payment. The financing parties rely on these capacity payments to repay debt and equity and if those are not paid, they get—as you can tell, the projects get into trouble.

The other thing I would just quickly add is there needs to be a clear permitting process, and I think it started favorably, between the State and the Federal Government. There is, as most know, an accelerator or emergency permitting program, which is a 21-day or 4 month program, depending on when this new capacity comes on line. I would urge the Federal Government to have the EPA work closely with the State EPA to have a cohesive, single committee so that we are not forced to deal with the State and then have to turn around and have a different set of rules at the Federal level. And I think that is really important to try to get capacity on line.

That is enough for now.

Mr. BURTON. We will get to questions with you, Mr. Vanech in just a minute.

Mr. Desrochers.

[The prepared statement of Mr. Vanech follows:]

California Gas Fired QFs
Testimony of Dean Vanech before
The Committee on Government Reform
of the United States House of Representatives
April 11, 2001
San Jose, CA

I. Overview of Delta Power Company, LLC ("Delta")

- Delta is a privately held company with offices in New Jersey, California, Texas and New Mexico. Delta owns and manages, through subsidiaries and affiliates, thirteen operating plants in the U.S., including twelve natural gas-fired projects.
- Our operations focus on clean, highly efficient natural gas fired cogeneration, providing thermal energy and electricity, and include five gas-fired QF cogeneration facilities in California.
- The California QF projects sell energy and capacity to Southern California Edison (SCE) and Pacific Gas & Electric (PG&E) under long-term agreements approved by the California PUC. Our steam hosts in California include industrial facilities, State universities and a State prison
- Delta's California capacity is presently 180 megawatts, with immediate plans to add another 200 megawatts to be available in 50 megawatt increments commencing in September 2001.
- At present, four of the five Delta owned and managed California QFs representing 150 megawatts are not operating, because SCE and PG&E have refused to pay amounts owing for past deliveries and to make assurances of payment for future deliveries, which prevents us from paying our fuel and other suppliers; and because their actions and those of the California PUC prevent the projects from covering variable operating costs (primarily fuel).

II. Brief History of QF's

- Congress created QFs by passage of PURPA (federal) in 1978, to reduce reliance on imported energy and to obtain the benefits of smaller, more efficient generation, including cogeneration.

- Many QF projects were developed around the U.S., with California leading the initiative by strongly supporting these efforts. The projects were financially supported with long term power purchase agreements with the utilities, while giving the utilities the right to flow through these QF purchases to their ratepayers
- These projects were financed on the basis of PURPA's provisions, including a realistic avoided cost recovery and certainty of capacity payments, in addition to contract sanctity.
- California has the largest and most diverse number of QF's in the U.S., totaling approximately 10,000 megawatts. Of this amount, approximately 5,400 megawatts are natural gas fired QF facilities with the balance from renewable resources.
- Today, these QF facilities provide almost one-third of the power capacity to the three IOU's. The QFs have consistently provided clean and reliable power to the state since the mid 1980's. Continued operation of the QFs is essential to meeting California's electricity needs.

III. Views and Observations

- An adversarial relationship has nearly always existed between the utilities and the QFs for a variety of reasons, including:
  - A loss of control by the utilities of the State's generating plants
  - Fears that QF power purchases could be more costly to the ratepayers even though the purchase costs were tied to the utility's own costs
- Gas-fired QFs have been constantly under attack by the utilities
  - A large number of regulatory efforts have been presented by the utilities over the years to reduce rates paid to QFs, often without regard to the QFs requirement to procure natural gas at market rates
- Utilities have accused gas-fired QFs of making huge profits at the expense of the ratepayers
  - A significant number of gas-fired QFs have been marginal or money losers over the years due to depressed energy prices. During the last year, many gas fired QFs earned

reasonable profits with the increase in gas prices, but some actually lost money on the margin. The QFs profit is a direct function of its plant heat rate. To the extent the QFs heat rate is higher that the IER rate used in the SRAC formula, the QF actually loses money for each kilowatt it produces. However, even these facilities continued to honor their contractual obligations.[1]

- ▲ QFs contracted to provide power to the utilities over a long-term period (up to 30 years) with fixed capacity payments. Over certain short-term periods of time, QF power costs have been more expensive than short term purchases otherwise available to the utility. It is imprudent and financially inaccurate to compare a long term "product" with a short-term product. In 2000 alone, the QF's saved SCE *over $800 million,* with comparable amounts to PG&E. We expect the savings to amount to well over *$200 million per month* during 2001 assuming the QFs are able to return to service. These savings are compared to otherwise available market prices.
- ▲ Significant benefits have accrued and continue to accrue to the utilities and its customers from the gas fired QFs, including:
  - ▲ A significant increase in overall system security by providing a diverse number of generators as opposed to a few central stations
  - ▲ Ancillary benefits including VAR support and system stability
  - ▲ Substantial savings to California industry through the use of otherwise wasted energy (heat and steam)
  - ▲ Clean energy as the non-renewable generators have utilized state of the art technology and burn natural gas
- ▲ Gas fired QFs have been consistently cooperative with the utilities and have worked to find constructive resolutions to areas of disagreement (recently demonstrated in state senator Keeley's legislative efforts), even to the QFs detriment.

[1] *The heat rate and IER both represent the number of BTU's required to produce a kilowatt hour of electricity*

- Gas fired QFs have no control over the cost of natural gas at the California border, and in may cases are indifferent to the gas cost as most of the benefits of higher gas prices are retained by the gas suppliers.
- The recent CPUC decision, imposing an IER of 9,140 BTUs does not represent *incremental* heat rates "avoided" by the utilities. The utilities' *average* heat rate over the past 20 years was around 9,900. The true IER is well above 11,000, with the most recent SRAC prior to the CPUC decision at 10,100. However, in an effort to attempt to provide relief, the gas fired QFs agreed to a lower negotiated heat rate. Two of the three utilities agreed to this "compromise". SCE did not.
- Utilities need to stop bashing QFs. It is convenient to blame QFs in part for the current problems, but in reality, the QFs are a large part of the solution. QFs are saving the ratepayers huge sums each month (when they operate)

IV. Current State of Affairs

- The vast majority of gas fired QFs cannot run today under existing standard offer contracts for the following primary reasons:
  - The QFs are owed huge sums of money from the utilities, and cannot pay fuel suppliers for deliveries made as far back as November and December 2000, creating the possibility of certain projects having to seek bankruptcy protection. Given this liability, it is impossible to induce gas suppliers to commence gas deliveries without up-front payments.
  - The current SRAC formula is grossly unworkable due to an unrealistic IER rate and an unrealistic gas index (Malin Vs. Topock). The CPUC decision requires the use of Malin pricing in the revenue formula, but Malin is now <u>$5.00 lower</u> than Topock, the index actually used in QF gas contracts. In simple terms, the QF cost to produce at a 10,000 heat rate is $140 per MWh (fuel only), while the CPUC decision would limit revenues to around $90 per MWh.

- ▲ It is becoming more difficult to procure natural gas capacity, with very tight balancing requirements – expected to become worse in the summer.

▲ SCE has not made payment to QFs since early December 2000 (for October deliveries) and PG&E has made only 15% payment to QFs since January 2001. Both utilities have been accumulating cash received from their ratepayers, while not paying DWR or us.

▲ Many QFs are seeking relief through the court system until the SRAC formula is restored to its proper consistency with federal and state laws and the utilities are able to pay their debts. At least some gas suppliers will enter into "tolling" agreements and pay the QFs a "fee" for converting gas to power. These arrangements avoid the gas credit issue, and keep power flowing in California.

▲ The gas-fired QFs steam and electric customers are incurring additional financial and operating hardship as a result of the QFs being shut down, exacerbating the economic downturn and the risk for both energy supply and the economy this summer.

▲ The State desperately needs gas fired QFs to restore operations by around May 1 to provide for increasing seasonal demands. If the current state of affairs continues, QFs will have to reduce or eliminate staff; and when time to resume operations, the plants will lack operators and plants will remain idle for a longer period of time.

▲ The utilities refusal to pay, and refusal to allow QFs to make interim sales to credit worthy third parties reduces capacity available in California, hurts California consumers, in addition to being contrary to federal law.

V. <u>What Can Be Done</u>

▲ **Immediate**

- ▲ The State or FERC must allow interim sales to credit worthy third parties or DWR, so that California consumers will not be deprived of available electric energy that the utilities are currently preventing from getting to market, and to avoid the QFs from bankruptcy.

- ▲ Revise the SRAC formula to be consistent with federal laws and Congressional intent as a top priority. The gas fired facilities must be able to operate under the rules of PURPA. The gas fired QFs have and will continue to work with the utilities and the lawmakers to enter into longer term gas arrangements to bring down the cost of fuel and power. The IER needs to be realistic, and the gas index contained in the formula needs to represent a gas price actually available to the QFs.
- ▲ Restore creditworthiness to the market:
  - ▲ Most gas fired QFs have the flexibility to defer past amounts due by working with their fuel suppliers and lenders *provided* that the payment of these amounts are certain as to timing and supported by a creditworthy entity.
  - ▲ In light of the recent PG&E Chapter 11 filings, lenders and investors must regain confidence with the market in order to lend to new projects. If lenders and investors in QF projects are forced to take write-downs or write-offs, capital will be very scarce at best as investment in these projects has been viewed as secure by the financial institutions.
  - ▲ The Federal Government, although reluctant, may need to consider providing financial assistance to the state or the IOUS to restore liquidity to the market.
- ▲ Utilities must continue to pay QFs for firm capacity, including amounts owing while plants have been shut down. The QFs rely on these payments and the shutdowns have occurred only as a result of the utilities' non-performance
- ▲ In coordination with the Federal government, continue to develop a responsive, transparent and fair permitting environment

▲ Longer Term

- ▲ Recognize that gas fired QFs are different from renewable QFs. To date, a single SRAC formula has been used (consistent with Federal and State laws). However, due to fundamental shifts in the gas markets, it is prudent to evaluate a bifurcated avoided cost for gas and non-gas QF's. This effort will take time and be subject to intense debate since the renewables will not want to take a lower rate that gas fired QFs

- A market needs to be established to buy and sell power. Since the PX was dissolved, there is no clearing house for power. This makes the market unwilling to commit large sums to build new plants due to lack of a market, and more likely to suffer from manipulation. A gradual reintroduction of a power clearing mechanism is required.
- The rates paid by user of electricity must reflect the true cost of the commodity. Progress has been made with recent rate increases, and attention to the rate structure must be done in a consistent manner.
- The State needs restore consistency in its energy policy. In order to attract new generation that is critically needed, a sound regulatory environment must be implemented. If the generating community perceives that the regulators are focused on over regulating and attacking its business, it will build elsewhere.

Mr. DESROCHERS. Good morning. Chairman Burton, Representative Ose and committee members, thank you for the opportunity to meet before your committee to discuss the current energy crisis and its impact on the biomass to energy industry in California.

My name is Paul Desrochers, I am the director of fuel procurement for Thermo Ecotek. We own and operate 125 megawatts of energy, both in New England and in California, 100 megawatts in California.

The industry in total in the State of California is—we have 29 biomass to energy facilities currently operating, producing over 600 megawatts of energy, of renewable energy.

But I think my message today is not only are we producing electrons to the State of California, we are also providing substantial environmental benefits. Those are primarily air emission reductions, reduced greenhouse gases while consuming material that is normally open burned in the Central Valley and also material that normally would go to municipal landfills. And I am not talking about regular household waste, I am talking about wood waste that is, you know, tree trimmings from your home, grass clippings, that type of material. All that material would, if we did not exist, go to the landfill.

In California alone, we utilize 700 million tons of that material a year on an annualized basis. So again, if our facilities do not operate, which some of them are not currently operating, that environmental benefit goes away also, the State pays again. And as Mr. Vanech mentioned, it has to replace that energy with higher priced spot energy.

Not only do we utilize that, in the Central Valley, we provide 1,200 post-harvest jobs. That is extremely important in our Central Valley because of its unemployment during the non-crop season. All of our operations are—not the facilities, but the collection, processing and gathering operations are all done post-harvest, after the harvest of whatever crop that they are working on—very important.

These facilities are under long-term agreements with the utilities, both Southern California Edison, but primarily Pacific Gas & Electric. And as Mr. Vanech has said, as of April 1, these facilities have not been paid for at least 3 months and in the case of Southern California Edison, 4 months. Thermo Ecotek's facilities are currently owed—currently right now, $12.1 million for energy delivered since December.

The energy crisis in California, as we have all heard, deepened as PG&E has sought protection under Chapter 11. Just prior to PG&E's decision, the State Public Utilities Commission ordered the utilities pay our facilities, which were called qualified facilities or QFs, for the energy generated after April 1, with no provisions for past-due. These facilities have been operating for the last 3 months, providing energy to the State of California, while the California Department of Water Resources are making prompt payments to out-of-state generators. That to me is criminal. Here we are in-state generation not getting paid, out-of-state generators getting paid. Something is wrong with that equation.

Our facilities have continued to operate and provide energy to the State of California, providing the environmental benefits that we provide, hopeful that there would be a solution in the last 3 months, based on efforts the Governor has been working on, California Public Utilities Commission and attempts through the legislature. All those have failed. We are still not sure the power line acquisition from Southern California Edison is going to work.

Unfortunately, we have waited too long to discontinue our operations and we are at the end of our ability to fund our fuel purchases and our operating costs. What is most unfortunate, as I have said before, is not only does the State lose the renewable electrons that we produce, the State is also going to lose the environmental benefits that we provide.

I will list you an example of that. The San Joaquin Valley Unified Air Pollution Control District, which is the second largest air pollution control district in the State, is about to be placed under severe non-attainment for ozone. Our facilities reduce 32,000 tons of material that are precursors to ozone development, on an annualized basis. That is a substantial amount of material, substantial emissions reductions.

Additionally, our facilities utilize 3 million tons of urban wood waste, which we have talked about, the material that would go to municipal landfills. We are the only renewable energy technology that has to pay for its fuel, because of the cost of collection, processing and transportation, we have to pay for our fuel. Wind, obviously geothermal does not a fuel cost.

We have reduced the amount—just in the last 2 months, we have reduced the amount of material that we are currently—we normally utilize, by half. So the State has already lost half of its benefits, and we are looking at, if we do not receive payment, based on the PUC ruling, by April 17, we probably will discontinue power generation.

Mr. BURTON. Mr. Desrochers, could you summarize so we can——

Mr. DESROCHERS. Yes. Without rapid resolution of our current contract payments, we will suspend operations—I just said that.

We do not know what their future brings. The Bankruptcy Court will do one of two things, either affirm our contracts or reject them. We feel that being—either way will be a positive move, but at least there is some forward movement.

What we would ask is that as you return to Washington, that our industry is proposing similar to the wind industry, an energy tax credit that will help some long-term viability and also we would support, as Congressman Lee has said, renewables in the United States and in the State, and we call it a renewable portfolio standard, that with a national energy policy and with a State energy policy, that at least 20 percent of that generation is based on renewable technology, and we would support that.

Thank you.

[The prepared statement of Mr. Desrochers follows:]

Testimony

For the Committee on Government Reform
U.S. House of Representatives

On the

The California Energy Crisis

Wednesday April 11, 2001

San Jose, California
By

Paul E. Desrochers

Fuel Procurement Director
Thermo Ecotek Corp.

Chairman Burton, Representative Doug Ose and Committee Members:

Thank you for the opportunity to come before the Committee on Government Reform to discuss the current energy crisis and its impact on the Biomass to Energy Industry in California. My name is Paul Desrochers, and I am the Director of Fuel Procurement for Thermo Ecotek Corporation. Thermo Ecotek Corporation owns and operates over 125 MW of Biomass to Energy facilities located in both New Hampshire and California. There are 29 Biomass to Energy facilities currently operating in California producing over 600 megawatts of **renewable energy** while providing substantial reductions in air emission, including green house gasses, while consuming wood wastes that historically have been open field burned or disposed of in municipal landfills. . Our industry utilizes over 7 million tons of agricultural, urban, yard and forestry waste annually while providing 1200 post- harvest jobs, which is extremely important in California's Central Valley.

The majority of these facilities are under long-term contracts with Pacific Gas and Electric Company and Southern California Edison Company. As of April 1st, 2001 these facilities had not been paid for at least three, and some cases four, months of generation deliveries. Thermo Ecotek's facilities are owed more than $12 Million Dollars for energy delivered since December. The energy crisis in California deepened last week when Pacific Gas & Electric filed for Chapter 11 protection. Just prior to PG&E's decision, the state Public Utilities Commission ordered that utilities pay the qualified facilities for energy generated after April 1st with no provisions for back payments. These facilities have been operating for the last three months providing energy to state of the California without payment while the state California Dept. of Water Resources are making prompt payments to out-of-state generators for energy. Our facilities continued to operate providing energy to the state of California hopeful that they would be resolution based on efforts from the governor, California Public Utilities Commission and attempts through the Legislature. Those efforts never came to realization. The Biomass to Energy industry is the only renewable energy that must pay for is fuel. Unfortunately we waited too long to discontinue operations and we are at the end of our ability to fund our operating cost including fuel which reduces California's environmental liabilities.

What is most unfortunate is that not only does the state lose the renewable electrons that our industry produces it also losses environmental benefits that are industry provides, for example.

The San Joaquin Valley Unified Air Pollution Control District is about to be re-classified as severe non-attainment for Ozone and in less than a year be subject to EPA restrictions. Based on an independent study it is estimated that the Biomass to Energy Industry reduces in excess of 32,000 tons annually of criteria pollutants by avoiding open field burning. Additionally our facilities utilize 3 million tons of urban wood waste, which would normally be disposed of at municipal landfills taking up landfill capacity and producing green house gasses.

We are the only renewable energy industry that must pay for our fuel that provides environmental benefits. We have already reduced the amount of material that we utilized as fuel by one half thus reducing those benefits while remaining fuel supply is being delivered under 90 day payment terms due to cash flow constraints. Without a rapid resolution of our current contract payments by the utility we will suspend operations and receiving fuel.

At this time do not know what are future brings. We are hopeful that the bankruptcy judge will expediently offer "QF's" under contract with PG&E the choice of two options: one, to release us from our existing contract obligations with the utility so that we can provide energy in the open marketplace, or two, acknowledge our contracts with a guarantee of payments going forward. In either case, we would further ask the judge to require PG&E to pay us for past due amounts for energy and capacity deliveries made since November.

We thank this committee Chairman Barton, Representative Ose and other committee members for focusing on this issue. Your interest will stimulate much needed action and consideration of new remedies.

As you return to Washington, California's Biomass to Energy Industry ask that you lend your support to a proposed Biomass to Energy production tax credit similar to that that currently applies wind energy. We expect this to be introduced in legislation authored by Congressman Wally Herger just after your spring recess. For our facilities and the other biomass power facilities around the country this tax credit is essential to stabilizing our energy production while supporting the high fuel cost that provides unique environmental benefits.

Mr. BURTON. Thank you, Mr. Desrochers. Let me just start with you, Mr. Desrochers, I did not catch that last part, I am sorry. Congresswoman Lofgren and I were talking, but I was told that the alternative sources of energy that are produced, like what you are talking about, accounts for what, about 25 percent?

Mr. DESROCHERS. No, in this State here, we are only a little less than 10.

Mr. BURTON. A little less than 10 percent, but that is a significant amount.

Mr. DESROCHERS. I am sorry, I misstated that, less than 2 percent.

Mr. BURTON. Oh, less than 2 percent.

Mr. DESROCHERS. 2 percent.

Mr. BURTON. But that still makes a dent.

Mr. DESROCHERS. Yes.

Mr. BURTON. Let me start off with questions for California Edison and PG&E. Last summer, were your companies engaged in negotiations on long-term contracts for electricity?

Ms. HAPNER. Last summer, we had very little authority to go out and sign long-term contracts. Ever since the deregulation policies at the Commission and at the State legislature passed, we have tried to move in that direction. We have requested several times the authority to enter into long-term contracts to be relieved of the buy-sell provision, etc. and to hedge, so that we would not be forced to operate in the volatile spot market.

In 1999, we received very limited authority to make some long-term purchases through the Power Exchange, the block forward market, and then in August 2000, we received broader authority to sign longer term contracts, but without the reasonableness protection that we require to protect ourselves after the fact.

Mr. BURTON. So you were not negotiating at that time in long-term contracts?

Ms. HAPNER. On a very——

Mr. BURTON. We heard yesterday and I think day before when we were on our way out here, that you had an opportunity and entered into a 5-year contract or contracts at around 5 cents a kilowatt hour, in that neighborhood; is that true?

Ms. HAPNER. Yes and no. We did not have the authority to enter——

Mr. BURTON. Was that offer made?

Ms. HAPNER. I beg your pardon?

Mr. BURTON. Was there an offer made to you for 5 cent per kilowatt hour?

Ms. HAPNER. When we investigated those offers, they were not what they appeared to be and what were covered in the media.

Mr. BURTON. What were they?

Ms. HAPNER. They were considerably higher than 5 cents, particularly for peak period.

Mr. BURTON. So there were no 5 or 6 cent per kilowatt offers made?

Ms. HAPNER. Certainly not in the last spring and early summer timeframe. We did——

Mr. BURTON. Going back to April, May, June of last year.

Ms. HAPNER. No, we did not.

Mr. BURTON. What was the lowest offer you had?

Ms. HAPNER. I do not know for sure, Mr. Chairman——

Mr. BURTON. You do not know?

Ms. HAPNER [continuing]. That is not my area of expertise.

Mr. BURTON. Does anybody know? Do you know?

Mr. PICKETT. No, sir, I do not have the exact number. We can get the numbers that were made available to us and present them to you, if it is of benefit to the committee. We found, as PG&E apparently did, that a number of generators made offers, usually through the press, not directly to us, that they were willing to sell us power, a figure that was tossed around in the early or late spring, early summer of last year was 5 cent power. We also found——

Mr. BURTON. Did anybody contact the people who were making these assertions in the paper to see if that was a fact?

Mr. PICKETT. Yes, sir.

Mr. BURTON. And what did they say?

Mr. PICKETT. It proved, on investigation, not to be the fact. The terms of the contract would have ultimately made them substantially more expensive.

Mr. BURTON. OK, what did the terms of the contract take it up to?

Mr. PICKETT. Again, I do not have that specific figure. Ms. Hapner apparently has some information, but we can go back and look at that record and provide it to the committee, if it would be helpful.

Ms. HAPNER. I do not have the specific information, Mr. Chairman, but I can tell you that those contracts were for a considerably longer period of time, up to 10 years, and we did not have the authority to sign long-term contracts.

Mr. BURTON. Well, let us just say that there was a 10-year proposal made. Do you know how much that was for?

Ms. HAPNER. No, that is some of the information I will have to get back to you.

Mr. BURTON. Were the long-term rates that you heard about considerably lower than the short-term spot rate?

Ms. HAPNER. Absolutely.

Mr. BURTON. Well, then why was that not pursued?

Mr. PICKETT. In our case, we did pursue it with several vendors who were proposing it. We have had I think three problems. One, the contracts and the offers did not pan out, they either were not there during the critical periods of time, the summer peak periods, or they were proving to be substantially more expensive than they were advertised.

Mr. BURTON. How much more?

Mr. PICKETT. Again, I do not have that number, but that is a figure that we can supply to you.

Second, we did not have the authority—even if the offer had been there, we did not have the authority to sign the contract.

Mr. BURTON. The authority would have rested with whom?

Mr. PICKETT. With the California Public Utilities Commission.

Mr. BURTON. And what was their position on those, or did you pursue that?

Mr. PICKETT. We pursued that vigorously beginning——

Mr. BURTON. So what happened when you pursued it with the California regulatory agency?

Mr. PICKETT. Well, if I may, I can back up and explain a little of the history, if that would be helpful to you. We started in March 1999 trying to get authority to do contracting, bilateral contracting, because we began to see then that the market was on an upward trend. And in July 1999, the PUC rejected categorically our request for authority to do bilateral contracts.

Mr. BURTON. Why?

Mr. PICKETT. Because they believed that at that time the Power Exchange provided the transparent pricing that would allow them to conclude that the prices that we were paying for power to serve our customers were reasonable. They wanted to see the transparent price and they wanted to be sure that the——

Mr. BURTON. I do not want to belabor this, but did they not see the projections that showed that the price of generation was going to go up?

Mr. PICKETT. I do not know if they did or did not. We tried to explain that what we were doing was hedging against price volatility and certainly the possibility that they would go up in 1999, and that argument fell on deaf ears.

Mr. BURTON. So they were not going to let you buy it at that price?

Mr. PICKETT. No, they—well, when you say at that price, in 1999, in July 1999, they categorically rejected our request for authority to do bilateral contracts.

Mr. BURTON. But the prices, according to the charts we got yesterday, started to go up appreciably around May of last year, sort of jumping up in quantum leaps.

Mr. PICKETT. Yes, sir.

Mr. BURTON. We were told—and I am out of time, but we were told that you could get prices in the 5 cent per kilowatt hour range during that timeframe. You are telling me that is not the case and you are going to let me know what you could have gotten it for. But they would not let you do that even though the projections showed that there was going to be some dramatic increases in cost.

Mr. PICKETT. Let me say for our part, we were prepared at one point to try and take a long-term low-price contract to the Commission for authority to sign it if we could get that——

Mr. BURTON. At what point, when was that?

Mr. PICKETT. That was already I believe in June or July. Again, I can get the precise information on this for you, but the contract we would have taken to the Commission never materialized.

Ms. HAPNER. I would agree with the comments that Mr. Pickett made. I would just say for our part, after either getting rejected or just having our request sit, we finally went out at our own risk, and we still do not have reasonableness protection, but we actually went out at our own risk and signed a series of contracts, several of them at about 5.5 cents.

Mr. BURTON. If the Public Utilities Commission had moved more expeditiously, would that have eliminated a large part of the problem you face?

Ms. HAPNER. Well, hindsight is 20/20, but certainly——

Mr. BURTON. You could see the problem at——

Ms. HAPNER [continuing]. We could have taken advantage of the opportunities in the marketplace.

Mr. BURTON. And had you taken advantage, would you be in the financial position you are in today? You can put a pencil to that.

Ms. HAPNER. Certainly the financial situation that we are in today is a function of collecting 5 cents from customers and paying upwards of 15 or 20 cents.

Mr. BURTON. You are not answering the question.

Ms. HAPNER. Well, clearly if we had—I do not mean not to answer your question—clearly had we been able to buy power in the wholesale market that was more closely related to the prices that we were collecting from our customers, we would have prevented the huge debt that we are in today.

Mr. BURTON. Ms. Lofgren.

Ms. LOFGREN. Thank you, Mr. Chairman.

Mr. Pickett, I was very interested in your testimony and I do not think I have heard anyone be as plainly spoken and concise as you in terms of what should happen. And on page 7 of your testimony you suggest that the FERC should essentially deal with the dysfunctional market by revoking market-based rate authority. And I actually have to say I agree with you on that.

I believe that the FERC should have been more aggressive in terms of refunds, it should have been more aggressive in terms of prospective control of price gouging and the like, but clearly that did not occur.

Our President has indicated an opposition to price caps, the Secretary of Energy and Mr. Hebert as well. So I guess my question to you is not getting plan A that might be the best way to deal with our situation right now, what advice would you be able to give for the market manipulation controls that Mr. Hebert discussed this morning, that I think are at least apparently some intention to prospectively control price. How could that be structured best to help California avoid further price gouging.

Mr. PICKETT. Let me say that I regard price caps as the second best alternative from either perspective. I regard price caps, you know, a working, competitive market, even one that may be approaching a supply shortage, as providing some of the disincentives that Chairman Hebert and others have said. They are not a good solution. But when you have a broken market——

Ms. LOFGREN. I agree with you on that as well. I wanted to limit my question to the comments that relate to a dysfunctional market in an emergency situation.

Mr. PICKETT. I think in the current situation, I cannot conceive of a real practical way to make this market work. The market structure is so badly flawed that we have to stop, we have to take time out and say this is not working. You cannot set a just and reasonable rate using a proxy derived from a non-functional market, which is what the FERC's last order did. That does not work.

So I would suggest to Chairman Hebert—and if I had the drafting pen, I would write a suspension of market-based rate authority for the entire Western region. I believe he is right when he says you cannot look at a narrow region, you have got to look at the whole region. Electricity does not stop at State borders.

But you have to not just withdraw the market-based rate authority, you have to have a system that both fairly compensates the generators—cost-based ratemaking does that, it provides them a fair return on their investment and, as the general counsel of the FERC indicated, a number of these generators paid amounts substantially above book when they purchased the generating assets. None of us may like that today but it is a fact and those people who paid that money I think are entitled to, if they are going to be compelled to operate, are entitled to earn a fair return on that money, regulated by the FERC.

That is not a complicated operation, I have practiced in this area for 20 years. I cut my lawyer's teeth doing FERC rate cases. I know how the system works.

The Federal Power Act and the regulations are in place. Cost-based ratemaking is the norm, it was done for 60 years. And I do not find it an acceptable excuse that the FERC says well things back up. Give me a break. Everything backs up if you do not turn attention to it. They need to turn attention to it, focus on what the law and the regulations are and enforce it.

Ms. LOFGREN. Let me ask you a question about our future. We have nine power plants under construction in California right now, I think the first one is set to fire up in June. We have 13 more that have already received approval. When those 9 are up and running and the 13 are up and running, are we going to be able to meet our power needs, or what further are we going to need to do in terms of—you know, we've got approval rates down to 6 months, we are 48th in terms of energy conservation in the State—among the States. What else are we going to need to do to be healthy energy-wise.

Mr. PICKETT. I smiled at your question because the power plant that we hope starts up first is a power plant being built by an affiliate of my company and in the MOU we signed on Monday, if it is not up and running by mid-August, we are subject to a significant penalty. So I indeed hope that power plant and all the rest come on line.

Beyond that, I think we need to assure that there is an obligation to serve here. What is missing in this market equation today is the obligation to serve that was imposed on utilities in return for the regulated rate of return. The example are the blackouts. During the blackouts, we had 14,000 megawatts off line. In a period of low load, there was no shortage, none of those generators had an obligation to be on line serving. We need to re-establish that in the short term until we can create the market mechanism that will incent them to be on line as a matter of economics, rather than withhold their power to drive prices up.

Ms. LOFGREN. Thank you, Mr. Pickett. I see my time is over, so I yield back, Mr. Chairman.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

I find I have more questions than we are likely to have time for, so I may be sending you written interrogatories for you to respond to, to the extent we can get to them we will reduce that pile. I want to go back to the original legislation that——

Mr. BURTON. Excuse me, Mr. Ose, real quickly, she has got one question, could we yield to her and we will start your time over here just real quickly.

Mr. OSE. Sure.

Ms. LOFGREN. You are very kind, Doug.

Yesterday, the president of the Public Utilities Commission apparently testified that they had never refused a request for long term contracts and we have heard testimony here today that contradicts that. So I am just asking the chairman, not here today obviously because Ms. Lynch is not here, but I think we ought to do some written inquiry to clarify that contradiction in testimony and I thank you for yielding the time.

Mr. BURTON. We will do that, we will send a note to her and hopefully you will respond in writing to that as well, so we can have both sides of that. All right?

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. I do want to tell my friend that it was very clear what Ms. Lynch was saying, but I do think it would be interesting to have it in writing.

I want to go back to AB–1890. As I understood AB–1890, the legislation defined a point beyond which the IOUs, the investor-owned utilities, would be free to charge retail rates based on market rather than a frozen level, it is embedded in the legislation to some degree or another. And that threshold was basically defined as the point at which the utilities declared that they had recovered their stranded costs.

Ms. Hapner, Mr. Pickett, is my understanding correct?

Mr. PICKETT. I think in the broadest sense, yes, but I would like to define a couple of key terms so that we are not talking past each other.

AB–1890 envisioned deregulating the generation market, not the utilities' distribution lines or transmission system, which would be transmission under the regulation of the FERC, the distribution under the regulation of the PUC, on a regulated, rate of return basis, as it has always been done. In our case, until the recent rate increases, we were charging a system average rate of about 10 cents and about 3 cents of it was transmission/distribution and the regulated portion of the business.

The generation portion of the business, AB–1890 envisioned moving that to a competitive environment and both the PUC's prior implementing orders and AB–1890 provided incentives designed to get the utilities to sell their generation and in fact, until this market melted down, we were in the process, as a utility, of moving out of the generation business.

But I think in direct answer to the central question, if the market had not melted down and if the utilities retained their generation with a possible exception for some nuclear issues, and the PUC had gone through what they referred to as the valuation process for our plants that were designed to compensate the ratepayers for those plants, post-valuation the unregulated side of the utility would have had a generator that it could have sold into the market.

I hope I have not bored you with detail, but the process envisioned doing a market valuation process with the generation and then allowing the utilities, to the extent they retained that generation, to sell it into the open market.

Mr. OSE. Ms. Hapner, before I get another answer of that nature, let me ask the question differently. Did the legislation define a date certain at which the utilities would be free to price their retail power delivery without CPUC jurisdiction?

Ms. HAPNER. The legislation said that the rate freeze, which was part of the legislative package, would end either when the utilities had collected their stranded costs or no later than December 31, 2001.

Mr. OSE. December 31, 2001. So December of this year.

Ms. HAPNER. December of this year.

Mr. OSE. Is that your understanding, Mr. Pickett?

Mr. PICKETT. Yes, that is correct with the possible exception of a 3-month stub period that would have taken it to the end of March 2002. But clearly there was an end date, one or the other, anticipated.

Mr. OSE. Has PG&E, Southern California Edison or San Diego Gas & Electric submitted to the PUC filings that say they have recovered their stranded costs?

Ms. HAPNER. Yes, on several occasions—well, first let me say that monthly, each utility provides an accounting of the stranded costs that have been collected up until that point. And we, per CPUC regulation, had alerted the Commission that we were very close to recovering our stranded costs and that surely when the valuation of our hydro facilities was made, that the stranded costs would have been collected. We estimate that at the latest, that was last summer.

Mr. OSE. Summer being July, August, June?

Ms. HAPNER. By August.

Mr. OSE. Mr. Pickett, is that similar to what Southern California Edison did?

Mr. PICKETT. Yes, sir, we also submitted a filing indicating that our stranded costs had been collected in the early August timeframe.

Mr. OSE. So at that point, your contention was that under the legislation, you were then free to go ahead and use market-based retail prices.

Mr. PICKETT. For the generation; yes, sir.

Mr. OSE. For the generation. And how did the PUC respond?

Mr. PICKETT. The PUC has basically declined to end the rate freeze and there are a whole series of intervening steps, but on March 27, they issued an order that retroactively reversed a number of these accounting procedures such that if you accept the legality, which we do not, but if you accept the legality of what they have done retroactively, it would say that the stranded costs have not been collected.

Mr. OSE. Mr. Chairman, if I could just get Ms. Hapner's response. I see my time is clearly out.

Ms. HAPNER. That is absolutely true and in fact, they would never be collected by the statutory end date of the rate freeze.

Mr. OSE. Under the new definition.

Ms. HAPNER. Under the new so-called accounting change. We would go back to the beginning, January 1, 1998 and take all of the costs that we collected per the legislation and use those dollars to pay for the generation costs on behalf of customers.

Mr. OSE. I have to yield back. We will come back to this question.

Mr. BURTON. Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

OK, to Ms. Hapner, first let me just say of course, PG&E filing bankruptcy does not settle very well with me. And the irony of this is that many consumers now are going to be paying, as they are now, and in the future, paying higher utility rates and yet unfortunately bankruptcy laws have been changed now that will make it harder even for consumers who have to pay these higher rates to file bankruptcy and yet PG&E can do this so easily.

Now we have read in the newspapers that PG&E, before declaring bankruptcy, paid $1½ million, was it, in legal fees and distributed more than $50 million to employees and provided bonuses to CEOs of over $2 million. Also we understand and we have read, and I am asking this because I have just read this, that there have been—or at least there is about $30 billion in the parent company.

So what I am wondering is how do you reconcile declaring bankruptcy with these assets and expenditures. And I know that you made billions in 1998 and in 1999, and what happened to this money? Why has it not been used to pay off your debt? And finally, let me just say that there is no question where this money has gone in terms of the escalating costs, to the generators, and why have you not gone after them in terms of trying to find some relief, rather than filing bankruptcy or going to the State for assistance?

Ms. HAPNER. Let me try and handle those one at a time and if I miss one, please remind me—I am sure you will.

With respect to the profits that you mentioned in 1998 and 1999. Those were very different from the experience that we had in 2000. During that timeframe, the dollars that we were collecting per the rate freeze were enough to cover the wholesale generation costs. Beginning in May 2000, we experienced a gap that we have all referred to. The distortions in the market, which contributed to exorbitant prices.

With respect to going after the generators, we have been very active with our fellow investor-owned utilities and in some cases even the municipal utilities and with the Public Utilities Commission in seeking recompense from the Federal Energy Regulatory Commission and as Chairman Hebert said, some of those cases have been resolved, not to our liking and others are up for rehearing.

Moving to the choice to or the decision to seek protection of the Bankruptcy Court, let me first say I am not a bankruptcy attorney, so I cannot answer that question in much detail.

Ms. LEE. Well can you just tell me, do you know whether or not you transferred money to the parent company?

Ms. HAPNER. Let me answer that by saying that as vice president for the regulated side of the business, I can say unequivocally that we have complied with all of the Commission rules with respect to how the utility interacts with our corporate parent and our other businesses.

Ms. LEE. So if the rules allowed you to transfer money to the parent company, then there is a chance that you could have transferred it.

Ms. HAPNER. Others are much more familiar with the cash transfers and transactions than I am. All I can say is that we have followed those rules very carefully. We have been audited on those rules and have had our method of doing business blessed by the Commission. They have just begun a new proceeding and we look forward to that.

Ms. LEE. If possible, Ms. Hapner, Mr. Chairman, I would like to ask for the details of this to be submitted to the committee for the record, if you can do that.

Ms. HAPNER. Absolutely.

Mr. BURTON. Without objection.

Ms. LEE. Thank you very much, Mr. Chairman.

Let me ask you about the impact now of the bankruptcy filing on consumers and also on employees, those loyal employees who have worked for the company for many years, who have their retirement now at stake and also those senior citizens who, for example, have dividends coming in as a result of investments in the stable stock. What are they going to do now with regard to their dividends and their investments?

Ms. HAPNER. Basically, we were very clear in our statement on Friday, particularly with our employees, and our retirees that we take our obligation to serve very, very seriously, we do not expect that our business will change very much. Our employees have been dealt with very fairly. In fact, the $50 million that you referred to went to paying non-union, management employees—not officers or the CEO, I can attest to that personally—for their very good performance in the year 2000. So we do not expect employees to be laid off.

With respect to customers, customers are again—taking care of customers is our bread and butter business. We do not want our customers to suffer. We support the programs that the State and Federal Government has in place for protecting small users and customers who have limited means.

Ms. LEE. Mr. Chairman, may I have just 30 more seconds, please?

Mr. BURTON. The gentlelady is recognized for 30 seconds.

Ms. LEE. So are you saying that employees who worked for PG&E, say 20 or 25 years will be vested, their retirement is secure and when they retire, they will be able to benefit from what they thought they would have received as a result of working for that long for PG&E?

Ms. HAPNER. Again—and I apologize—I am not an expert in terms of the pension programs, but I understand that employees' retirements are safe. With respect to the dividend and the share holders at large, unfortunately, because of our economic situation, we have not been able to declare a dividend for this most recent period, but we are hopeful that with the reorganization of our debt, that we will get back to a credit-worthy status as soon as possible.

Ms. LEE. Thank you very much. Thank you, Mr. Chairman.

Mr. OSE. If I might just add something, one of the jurisdictional subjects that my subcommittee has is the Pension Benefit Guaranty Corp., I was telling Congresswoman Lofgren, we have looked at the funding at the Guaranty Corp. which would handle a failure of PG&E's pension plan, if it ever occurred. We looked at the funding, the Guaranty Corp. is very well situated and PG&E is on nobody's list from the pension plan side of things, as being vulnerable or subject to failure.

Ms. LEE. Thank you, Mr. Chairman. I think that is very important to make clear and to make public so people will understand that because there is a sense of panic out there.

Mr. OSE. We will be watching it as the says go forth. I am not speaking to the dividends to stockholders, I am talking about pensions.

Ms. LEE. Retirement pensions, thank you very much.

Mr. OSE [presiding]. Mr. Horn for 5 minutes.

Mr. HORN. Thank you, Mr. Chairman.

Most of you agree, I take it, 1999 was when, as one person said, the market was getting a little wacky. Do you all agree that is the date on that?

Mr. PICKETT. Speaking for Edison, Congressman, no. March 1999 was a date I believe I referred to and that was a date that we first applied to the California Public Utilities Commission for authority to do bilateral contracts. The market meltdown became apparent I think most clearly in early May 2000.

Mr. HORN. OK, do you all agree on that?

Ms. HAPNER. Yes, sir.

Mr. HORN. In sequence, gentlemen, what about you?

Mr. VANECH. Unfortunately, I do not have enough data with me to answer that question.

Mr. HORN. Well, was it about that time in the chronology?

Mr. VANECH. I recall that prices started to escalate about a year ago, actually started to escalate noticeably.

Mr. HORN. OK, that is the year 2000 or are you into the year 2001?

Mr. VANECH. No, in 2000.

Mr. HORN. 2000.

Mr. VANECH. That is correct.

Mr. HORN. OK, and as I listen to you and read your various interesting papers, you also think the Federal Energy Regulation Commission should have acted sooner; is that basically what your position is?

Mr. PICKETT. Speaking for Edison again; yes, sir, very much so.

Mr. HORN. Now those were done—and they would not extend it. And apparently the California PUC would not extend it either, is that correct?

Ms. HAPNER. Well, the California PUC does not have the authority to set the wholesale price, that is the purview of the Federal Energy Regulatory Commission. The PUC, along with Southern California Edison, PG&E and San Diego Gas & Electric went arm in arm to the FERC to extend them.

Mr. HORN. I think on the Federal side, I would like to know what kind of an environment you felt there, because that was just about before one administration followed the other and when you first went there, that was the Clinton administration and what changed? Now if you heard Chairman Hebert this morning, they are ready to roll and get things done, but you are saying there was just too much of a lag. So I am wondering what was going on, was there turmoil within the Commission and this kind of thing, because people are leaving and people are coming?

Mr. PICKETT. Congressman, I do not know and cannot speak to what effect the pending change in administration had on the thinking of the FERC Commissioners. We simply do not have insight into that. I think the history of what FERC had been trying to do since the passage of the 1992 Energy Policy Act by the Congress, is more instructive. They had been clearly trying to develop competitive markets and Edison supported that. We believe that a competitive market, a workable, functioning competitive market, is a better way to price goods and services than a regulated monopoly.

But the FERC also is the cop on the beat in those markets. And when the market began to melt down, frankly the cop on the beat was not there, they did not respond. Now Chairman Hebert said they are responding now, we have been pleased to see the progress, but we still have on rehearing at the Commission the decision from the first filing in August, that has not come out, that will give us a chance to test the unduly narrow view that the FERC has taken of its own jurisdiction and get it to a court for a decision. That has not come yet.

Mr. HORN. Now there is a Department of Energy and again, there were Secretaries coming and going. What, if anything, could the Department of Energy have done in default based on the Commission, was there anything that could happen, maybe jawboning if nothing else?

Mr. PICKETT. Well, the Department of Energy was actively involved in a fair amount of jawboning in the critical time of late December through January where the utilities were running out of cash, running out of credit, were unable to buy power and the State had not yet stepped in with its emergency legislation to give the State agencies the authority to buy power. The Secretary of Energy at that point signed a series of emergency orders designed to require generators to sell into California despite the looming credit-worthiness problem, and it is on an emergency basis to keep the lights on. And there was a lot of jawboning around that activity.

Mr. HORN. What is your feeling on that, Ms. Hapner?

Ms. HAPNER. That is my recollection as well. I would say that Secretary Richardson signed several of those orders and that was carried forward by Secretary Abraham into the spring of this year. There came a point when the Secretary did not want to renew those orders and I cannot recall exactly when that was.

Mr. HORN. And what did he do? Did he renew them? You mentioned that you were not sure——

Ms. HAPNER. I believe Secretary Abraham renewed those orders once or twice, I really cannot recall.

Mr. HORN. So the two of them agreed, the two Secretaries, on this, I take it.

Ms. HAPNER. I would not presume to speculate on whether or not those Secretaries of Energy agreed. Certainly on that point they both had a similar reaction.

Mr. HORN. Well, did those emergency signatures of theirs, did they gain anything from it and you gain anything from it?

Ms. HAPNER. Go ahead.

Mr. PICKETT. I do not think either company gained anything from it. The people of the State of California gained from it because the continuation of the emergency orders over the critical period in January allowed the State legislature to implement the necessary legislation to have the State buy the power, have a credit-worthy entity behind the power purchases, so the lights could stay on, thereby making continuation of the emergency orders unnecessary.

Mr. HORN. Well, if the Federal Commission was not doing enough at that point, it sounds like the State Commission was not doing enough.

Mr. PICKETT. We are clearly of the view that from May 2000 when this market started to melt and it was visible to everybody, that the governmental response on both sides was an unfortunate exercise in finger pointing, and it continued for way too long. I think we are starting to see responsible reaction by both the State and the Federal Government but we already have one of the major utilities here in bankruptcy and my company is on the edge of insolvency.

Mr. OSE. Mr. Horn, we are going to have another round.

Mr. HORN. I would like the questions I put earlier on this to be put to the chairman, because he is not here.

Mr. OSE. Chairman Hebert.

Mr. HORN. Right.

Mr. OSE. Without objection, so ordered.

I recognize the gentlelady from this area for 5 minutes.

Ms. LOFGREN. Thank you very much.

I am wondering if I could ask you, Ms. Hapner—and my constituents talk to me about this all the time—how much was transferred from PG&E to its parent corporation, what is the dollar figure?

Ms. HAPNER. Congresswoman, I do not have the exact dollar figure of transactions that have occurred over the years, it is fairly typical for subsidiaries of a parent corporation to shift dollars.

Ms. LOFGREN. Let us go from 1999 to present.

Ms. HAPNER. I do not have the exact amount, I would just reiterate that all actions that we took were in compliance with the Commission rules. I will get you that exact amount.

Ms. LOFGREN. Can we get the information? I would just observe that I understand that there are rules, but did the rules make you transfer the money or allow you to transfer the money?

Ms. HAPNER. The rules are very explicit in terms of how dollars can be used and it is very clear that the utility dollars cannot subsidize the activities of other parts of the business.

Ms. LOFGREN. Could you have used those funds that you recovered from sale of generation assets to improve path 15, for example?

Ms. HAPNER. The dollars that we recovered from the sale of the generating assets were designed to pay off the uneconomic generation costs and the accounting on those is pretty explicit.

Ms. LOFGREN. So you could not have used that for infrastructure, is that what your testimony is?

Ms. HAPNER. Dollars that we use for transmission and distribution—throughout the entire rate freeze process, we have continued to make capital improvements and we request dollars for those improvements on the distribution side from the Public Utilities Commission and on the transmission side, which would be path 15 from the Federal Energy Regulatory Commission.

Ms. LOFGREN. So is your testimony that you were prohibited from using the proceeds for transmission infrastructure improvements or that you were not prohibited from using that?

Ms. HAPNER. We used those dollars to recover stranded costs from generation.

Ms. LOFGREN. The question is what were you allowed to do with it, what were your options?

Ms. HAPNER. Well, I suppose that our option was not to pay for the generation costs that were incurred, not to buy generation on behalf of our customers and to mix dollars that were for power procurement and use them for transmission or distribution, which was not the intent of AB–1890.

Mr. OSE. Would the gentlelady yield?

Ms. LOFGREN. If you will give me a couple more seconds after I yield.

Mr. OSE. I will do so.

I think that is a very interesting question, whether or not the legislation underlying her restructuring allowed or disallowed certain actions with the proceeds of the restructuring. I think we ought to find that out.

Ms. LOFGREN. I think we should.

If I could ask Mr. Pickett, does Southern California Edison have a parent corporation?

Mr. PICKETT. Yes, we do.

Ms. LOFGREN. And were there transfers of funds to the parent corporation from you all as well?

Mr. PICKETT. Yes.

Ms. LOFGREN. And do you know what the dollar amount was say since 1999?

Mr. PICKETT. I do not know the dollar amount off the top of my head. We can get it and supply it to the committee. I can say that there are three categories of transfers and one may not have occurred in 1999, but the three categories of transfers are dividends of earnings to the parent company, payments of taxes to the parent company because the companies pay tax on a consolidated basis; and third, are in the category of special dividends. They were the return of the equity that had been invested in the generating plants that we sold. And all of that was done because the PUC, as a condition of our being allowed to have a holding company, requires the utility to maintain a balanced capital structure. And that means that there is so much of the utility financed with debt and a specified percentage financed with equity. If those dollars had been kept in the utility, the equity portion would have ballooned and we would have been out of compliance with the PUC's rules.

Ms. LOFGREN. Rather than ask either one of you to speculate as to dollar amounts, I am hopeful that we can get a written report from both companies to the committee.

Mr. OSE. Without objection, that question will be answered.

Ms. LOFGREN. Finally, Mr. Pickett, your strong testimony about the need for FERC to be more vigorous in its activities given the dysfunctional market, has I think a lot of agreement really, on my part at least. But there is discussion in the State now that if FERC does not take the kind of action, the strong action that you recommended and many other have, that the State of California will necessarily have to take some rather extraordinary measures; for example, using its power of condemnation to seize private companies and begin directly to control this market. What do you think that outcome would mean for the State of California?

Mr. PICKETT. I think it would be a very uncertain and expensive undertaking. The State, of course, can exercise the power of eminent domain but it must pay the fair market value for the assets. We are faced with a broken market that has created huge apparent value for the assets that might have to be paid for them. That could be hugely expensive for the State and at least in my perspective, not necessarily the best way to incent what we really need, new generation and an efficient operating market that will drive prices down. So that sort of extraordinary action I hope does not come to pass for that reason and I think the State has already taken some very extraordinary action. Rates have gone up hugely and that is a very painful thing to do for anyone.

Mr. OSE. Have we met your 2 or 3 seconds?

Ms. LOFGREN. I do not want to take advantage of the chairman's—that is sufficient for me and I will——

Mr. OSE. We will go around again. I do want to add that when Chairman Burton returns, we will insert his 5 minutes here at the appropriate spot and we will all defer to him accordingly.

I want to go back to the issue of the recharacterization that followed the PUC's ruling on stranded costs, which we were talking about earlier.

Both PG&E and Southern California Edison late summer 2000 filed with PUC documents that said we have recovered our stranded costs and under 1890 and PUC rulings, we should now be free to price our power, with certain caveats, at market; is that an accurate statement?

Mr. PICKETT. Yes, sir.

Mr. OSE. Ms. Hapner.

Ms. HAPNER. Yes, it is.

Mr. OSE. PUC turned around—took that under advisement and over a period of time responded. How long of a period of time before PUC action was taken on that filing?

Mr. PICKETT. The PUC action retroactively changing the accounting procedure was in a decision on March 27.

Mr. OSE. Of this year?

Mr. PICKETT. Of this year. The filings to end the rate freeze, August, September, October timeframe, there were a series of filings, but basically in the late summer, early fall timeframe.

Mr. OSE. Is that consistent with what PG&E did also?

Ms. HAPNER. Well, the one added piece is that at the order of the Commission, we filed an interim value for our remaining non-nuclear assets, our hydro facility.

Mr. OSE. That was the piece that put you over the top, if you will?

Ms. HAPNER. And that clearly put us over the top and that filing was rejected.

Mr. OSE. Has Southern California Edison submitted a similar filing for any of their non-nuclear assets?

Mr. PICKETT. Yes, sir, there were filings seeking authorization to sell our interest in three of our five major remaining power plants. We had contracts for sale of two coal-fired units, one in New Mexico and one in Arizona, excuse me, one in Nevada and our interest in the Palo Verde Nuclear Station in Arizona, we had sought Commission authority to do that. We had also filed a settlement we had reached with the consumer advocacy group at the California PUC that would have allowed us to retain our hydro generation assets and operate them in a quasi-market mechanism under California PUC regulation. Those applications had been submitted and we were waiting for action. One had been waiting for well over a year for action before the market melted down and a hold was put on this activity.

Mr. OSE. You are saying you filed it in May—let me see, the market started melting down in spring of 2000, you are saying you filed it a year prior to that or a year prior to today?

Mr. PICKETT. A year prior to that. The application to sell our Mojave Power Plant was filed, if memory serves here, and we can certainly get exact dates, that was filed in 1999.

Mr. OSE. OK, so these filings were made consistent with the legislative intent of 1890 that would basically empower the utilities to State, subject to PUC affirmation or rejection, that they had recovered their stranded costs and under the law, they could go forward with retail-based prices.

Mr. PICKETT. No, I am sorry, that is——

Mr. OSE. I just want to make sure I have got this clear because it is important to me.

Mr. PICKETT. In 1999, and up until the time the market began to melt down in May, we believed it was going to be necessary to sell our power plants, realize the gain, in order to pay off our stranded costs.

Mr. OSE. Right.

Mr. PICKETT. And we had engaged in doing that and we were engaged in a program to take the utility, the regulated utility out of the generating business under the incentives in AB–1890.

Mr. OSE. And those requests to sell those generating facilities are still pending.

Mr. PICKETT. Well, they are still pending. Pursuant to our MOU, they will be withdrawn, but those were the filings that I referred to that had been filed back into 1999. As the market price went up, and you have to bear in mind here, this is a very complicated and arcane accounting mechanism, but we were buying power from ourselves.

Mr. OSE. Right.

Mr. PICKETT. And we were doing it through the Power Exchange and we were paying the market-based price for it, not set by us, but set by the market. Those market revenues that we were being paid for our generation as we tried to sell it, we still owned it and were selling the electrons into the market, those market revenues were also going to pay off the stranded costs.

We reached a point and it depends on any number of variables, but we reached a point where we believed that without the sales, we had recovered our stranded costs.

Mr. OSE. I am going to yield to Mr. Horn for a question.

Mr. HORN. It is not unusual that a corporation gets rid of certain things so that they can show the stockholders, look at what we have in revenue this quarter, or this half year, or whatever. Now I think a lot of charges have flown around by both PG&E and Southern Cal Ed that they got rid of a number of things that generated power and they used the money to keep the stockholders happy, and I would just like to know what the policy is there.

Mr. PICKETT. Well, first of all, in our utility business, it is very unusual to sell assets. Selling assets that are dedicated to the public service requires the approval of the PUC to ensure that just that does not happen, that we are not churning assets for the momentary benefit of shareholders, but that at the same time, the long-run interests of our customers are being served. And it is our policy to serve the long-run interests of our customers and to do it under the rules set by the PUC, that as I mentioned a moment ago, require the balanced capital structure, require that we not have excess equity in the utility, increasing rates for customers, and as we went through deregulation, the utility business shrank, our earnings shrank and they shrank because we took the earning assets out of the utility.

Mr. OSE. I recognize Ms. Lee for 5 minutes.

Ms. LEE. Thank you, Mr. Chairman.

Let me direct my question to Mr. Vanech, is it?

Mr. VANECH. Yes.

Ms. LEE. You indicated in your testimony that the QFs are owed huge sums of money and that they cannot pay fuel suppliers. Let me just ask you this then. In terms of Delta Power's profits, what were they in 1999 and 2000? Do you have any idea, just ballpark?

Mr. VANECH. We have grown rapidly through acquisition. Boy, are you asking total corporate? We have 13 plants, 5 of which are in California.

Ms. LEE. OK, give me the California numbers, if you have them.

Mr. VANECH. I am afraid to say. I do not have the numbers at my fingertips, but I can certainly provide that to you.

Ms. LEE. Would you provide that for the record, 1999 and 2000?

Mr. VANECH. Yes.

[The information referred to follows:]

Summary of Net Income for the years ending December 31, 1999 and December 31, 2000 for Delta Power Company, LLC's California affiliates: (i) OLS Energy-Chino, (ii) OLS Energy-Camarillo, (iii) Carson Cogeneration Company, (iv) Mojave Cogeneration Company, and (v) PE Berkeley, Inc.

Year	Net Income
1999	$2,017,320
2000	$(1,801,341)

Ms. LEE. We would just like a ballpark figure——

Mr. VANECH. Yeah, that would be fine.

Ms. LEE [continuing]. Of what the profits were. The California Independent Systems Operators found that there was a potential of over—I believe it was $6 billion in overcharges by the generators. That represents approximately 30 percent of wholesale energy costs over the last year. How do you respond to that? Do you agree with that or is that an inflated number from your perspective?

Mr. VANECH. I understand the question. I can only respond from the perspective of qualifying facilities. The contracts that we sell to the utility—the contracts under which we sell to the utility essentially came out of Federal legislation and are in a sense—they are not regulated. The revenues we received are a function of the cost that the utility avoids, in other words, in not buying that kilowatt hour from another producer. So it is supposed to represent incremental cost. Clearly the rates have gone up across the board, including under our contracts. I mean, we are getting a lot more revenue then we were 6 months or a year ago, assuming we are operating. The other side to that is we have significantly higher fuel costs and some projects make more money, some lose more money as fuel prices go up. The key issue is how efficient that particular generator is compared to the overall market. I hope that makes sense to you.

With respect to the $6 billion, as we heard earlier—and I do not know the breakout specifically, but a significant amount of that appears to have come from non-QFs. I do not believe, to my knowledge, that the QFs are not being attacked as part of this $6 billion overpayment, because the QF contracts, as I said, really fall under Federal and State jurisdiction. They are based on a formula, as I said earlier, which is supposed to represent the utilities avoided cost.

Ms. LEE. OK. Well many believe that the generators are gouging and that is part of the problem, a large part of the problem. What do you say to that in terms of QFs role in price gouging? Is that an issue or not for you?

Mr. VANECH. I do not believe—and again, let me speak to gas fired projects, because there is a difference between renewables and gas fired. Mr. Desrochers may want to comment on the renewables. The incremental revenue that we have earned because of higher prices has substantially gone to the gas suppliers, and we can demonstrate that showing our profitability. So even though market prices have gone up dramatically, our profitability in some cases has actually gone down, in some cases have gone up or in some cases remained flat. We have not—these gas-fired QFs—and I can speak to our five—have not made any windfall profits as a result of higher energy prices. The big reason is because—the way the formula works, the utility formula, is that we get paid every month based on an assumed deficiency rate and the border gas price for that month. We buy gas from our gas suppliers based on that exact price that is used in the formula. In other words, there is a perfect hedge in a sense between the additional revenue and the additional fuel cost. It works when the fuel prices go up or down. But it has the effect of maintaining our margin to be a fairly constant number.

Ms. LEE. So you have not inflated your prices; you have not gouged and you have not withheld supply?

Mr. VANECH. Absolutely not. In fact, we have no ability to manipulate prices. The prices—and this is another important point. The prices we receive are set by the California Public Utility Commission each month. We have no control over the pricing we receive.

Ms. LEE. Thank you very much, Mr. Chairman.

Mr. BURTON. Let me—since I had to make a couple of calls, let me ask some questions I would have asked. I appreciate Mr. Ose taking the chair in my absence.

If the FERC imposes price caps, do you think there will be more or fewer blackouts this summer?

Mr. PICKETT. My judgment is there will be fewer.

Mr. BURTON. Why?

Mr. PICKETT. Because if the price cap is imposed at a level that is sufficiently reasonable that it will allow the generators to recover their fair costs, they will lose the incentive to withhold capacity from the market to drive prices ever higher.

Mr. BURTON. Do you agree with that?

Ms. HAPNER. Well, I believe that a price cap should be applied regionally. California is very a part of a larger grid, in fact, we are a net buyer of electricity. So clearly, we have to work and partner with the other Western States. I do think that if there is a price cap just in California, then we are likely to see some of the effects that you mentioned earlier in terms of megawatts following the money. Right now what we are seeing is, when there was a price cap in California the megawatts left California and then came back in as more expensive out-of-market costs. So clearly a cap, particularly a short-term cap to get us through this very difficult period, has to be a region-wide cap and that should very much help our situation.

Mr. BURTON. And if it is not a region-wide cap, then do you think that it would probably exacerbate the problem?

Ms. HAPNER. I am——

Mr. BURTON. If it is not a region-wide cap, the problem could be exacerbated as far as blackouts are concerned?

Ms. HAPNER. I would not speculate on the blackout situation, Mr. Chairman. What I would say is that if it was just a California cap or an ISO-wide grid cap as we had before, then it encourages generators that are not part of the ISO grid or regulated by the FERC—including the municipal utilities that Mr. Ose mentioned earlier—to certainly drive up the prices to stratospheric levels.

Mr. BURTON. And then the energy would go where the money is and you probably would have some blackout problems in those areas that couldn't break the caps, right?

[No response.]

Mr. BURTON. I mean, I know it is hypothetical, but if the FERC, as they said earlier, said they could only control 25 percent—put a cap on only 20, 25 or 30 percent of the market, that means that the other 70, if the prices went above the cap and was forced up, that is where the energy would go to produce electricity.

Ms. HAPNER. Well unfortunately that is——

Mr. BURTON. And in those——

Ms. HAPNER. Excuse me.

Mr. BURTON. And in those areas where the cap was in place you could have more severe blackouts, could you not?

Ms. HAPNER. I really cannot say about the blackouts. I do think, though, this is exactly the kind of example that Congresswoman Lofgren was referring to. In this type of crisis, we all have to pitch in, and that includes the municipal utilities who are not price constrained.

Mr. BURTON. I understand, but when you start making these kinds of decisions you have to look at every eventuality and what it is going—if you push in here, what is going to come out over here. What do you think the price cap should be?

Mr. PICKETT. Our belief is that the price cap should be set at a level that will allow the generators to recover their costs, plus a fair return on investment. It could be set—and I guess I would want to say that I would be very much opposed, or find a distant second best a one-size-fits-all price cap done generically, because there are substantial differences from generator to generator in terms of cost, the age of their plants, their fuel sources and so forth. What they need to be set, price caps, on a generator-by-generator basis at a level which provides cost recovery and a fair return on investment. That is the standard in the law.

Mr. BURTON. This letter from the Governors that was sent to Mr. Hebert had nine of the Governors on there from this region and they are not in favor of price caps. So a region-wide price cap might be a tough nut to crack there. So you may have a price cap only for California, and then I think you run into the problem we were talking about.

Let me ask you a couple of other questions. Did you ask the PUC in July to give you the authority to enter into what they call bilateral forward contracts?

Mr. PICKETT. Our request to the PUC for the bilateral forward contracts was made in April. I believe at that time the PX was then developing its bilateral forward program. It had not been adopted yet. The FERC approved the PX's bilateral forward contacting in May 1999, May 26th. On July 14, 1999 the PUC finally gave us limited authority to do bilateral—to engage in the—excuse me, not bilaterals, in the block forward market, but there was a very severe constraint on the amount of transactions we could do at that time.

Mr. BURTON. Now up to that time is it true that you were only allowed to purchase power through the PX or the spot market?

Mr. PICKETT. Yes, sir. Well when you say the spot market, that is to say through the ISOs' imbalance market, yes, sir.

Mr. BURTON. Ms. Lynch said that the PUC gave you the authority you needed to enter into long-term contracts. She said she rushed your proposal through in 2 weeks and got it passed on August 3rd, is that true?

Mr. PICKETT. I do not know if she rushed it through, but what was—this is now August 2000——

Mr. BURTON. Right.

Mr. PICKETT [continuing]. And what was done then was only half the job. They gave us authority to enter into bilateral contracts; they gave us no assurance of recovery of the costs of those bilateral contracts. The two have to go together. If you do not have assurance of recovery you are not a credit worthy entity. You cannot get somebody to sign a contract with you.

Mr. BURTON. Did you talk to her about that?

Mr. PICKETT. To the extent we could, yes, sir.

Mr. BURTON. What do you mean to the extent you could?

Mr. PICKETT. The PUC has a series of what they refer to as ex parte communication rules that prevent open communication between the regulated companies and PUC commissioners. We certainly did bring our concerns about the nature of the order and the limitations on it to the attention of the Commission through formal filings. I just cannot say to you that we—did we talk to Ms. Lynch about it? I do not know. We may have in various times, but it would have been under the constraints of the PUC's ex parte rule.

Mr. BURTON. As I understand—this will be the last question on this round. As I understand it, the PUC would not preapprove long-term contracts and the rates had to pass a reasonable test after the fact, is that right?

Mr. PICKETT. That is correct. I can give you the history here if you want. I think Ms. Hapner has something to say. After we got the authority in August, the PUC set up a preapproval procedure. Ms. Lynch has often said well, the utilities had the authority in August, they could have gone and signed contracts on their own nickel. As I just explained, that is not a realistic expectation. They also set up this preapproval procedure you have just referred to. We filed our contracts under that preapproval procedure in September 2000. By the end of October, even though there was a 30-day mandate in the PUC order, the PUC had not acted. We were ultimately able to sign those contracts only in November 2000, well after we were beginning to run out of credit and people were beginning to refuse to deal with us.

Mr. BURTON. During that time period, how much did the prices go up that month?

Mr. PICKETT. Sir, I do not know, but we could go back and——

Mr. BURTON. It was a big jump though, was it not?

Mr. PICKETT. It was a big jump, yes, sir.

Mr. BURTON. So if you had gotten the approval a little quicker you could have gotten a better price?

Mr. PICKETT. Absolutely.

Mr. BURTON. Go ahead.

Ms. HAPNER. Mr. Chairman, rather than take the committee's time, I would be happy to provide for the record a history of our requests for that authority. With respect to your specific question about conversations with the Public Utilities Commission and with President Lynch, again taking into account the ex parte restrictions that Mr. Pickett mentioned, we had several conversations with staff members of the Public Utilities Commission at high levels. The only guidance that we were provided was a figure of per se reasonableness that is actually several cents below what the Department of Water Resources paid for the power that they procured very recently.

Mr. BURTON. So it would not work?

Ms. HAPNER. We were told antidotally, but nonetheless, that even if we had criteria for reasonableness it would not be worth the paper it was printed on.

Mr. BURTON. OK, who is next? Mr. Horn.

Mr. HORN. Mr. Chairman, I will yield my time to Mr. Ose.

Mr. BURTON. You are going to yield your time to Mr. Ose?

Mr. HORN. Yes.

Mr. BURTON. OK.

Mr. OSE. OK, recharacterization of stranded assets. If I understand the basic impact of your application, it was to say very clearly that the capital base on which rates had been structured had been reduced to zero by recovery and that you now were willing to go into the open market and compete at the retail level; is that correct, Ms. Hapner?

Ms. HAPNER. I would say it a little bit differently, if you will permit me, Mr. Ose. AB–1890 said that when the assets were valued and/or stranded costs were collected, that those assets that were still with the utility family were free from regulation and could go out and be merchant plants, if you will.

Mr. OSE. At the wholesale level?

Ms. HAPNER. At whatever the market price was.

Mr. OSE. Now the impact—I think I understand the impact of Edison's and PG&E's filings saying that the stranded cost had been reduced to zero. What is the impact on the PUC's recharacterization—let me ask the question differently. Describe for me the PUC's recent recharacterization that effectively said no, you have not recovered your stranded cost. Keep it in layman's terms, OK.

Mr. PICKETT. I will try, and if I do not, let me try again. It is a very complex and arcane subject. Before the PUC recharacterized the accounting, AB–1890 and the implementation by the PUC provided three sources of revenue for the utilities to recover their stranded costs. AB–1890 and the PUC made it clear that the utilities were at risk for recovery of their stranded costs. The three sources of revenue were market revenues, revenue from the sale of the generating plants and headroom. Headroom is that amount of costs that we have in rate recovery above our actual cost.

Mr. OSE. It is the amount of rate over your basic cost?

Mr. PICKETT. That is correct. Those were the three sources of revenue for stranded cost recovery. When the market melted down and wholesale costs went up headroom disappeared and market revenues increased.

Mr. OSE. I got all of that part. I understand the dynamics there. What is the consequence to Edison of PUC's recharacterization now?

Mr. PICKETT. The important point to understand, though, here is that, in our view, the procurement costs were intended to be recoverable.

Mr. OSE. And when the market went up, you no longer had that avenue?

Mr. PICKETT. We may have lost stranded cost recovery but it was always intended that we would recover our procurement costs. The PUC disagreed with that in the implementation of AB–1890, and the recharacterization says that the first thing that will be recovered by the utility are the procurement costs and the rest is beyond.

Mr. OSE. So you went 3 years with one set of rules, or 4 years with one set of rules in terms of rate structure and what have you, and then March 28th, you had your world turned upside down, so to speak, in terms of how those funds—or how that rate base was supposed to impact your operations?

Mr. PICKETT. Yes, sir. And with the point that it was—the PUC said this was to carry back to the beginning, so it has retroactive effect, which we believe is illegal.

Mr. OSE. And that is the basis of your pending Federal lawsuit. Do you not have a lawsuit pending over this particular issue?

Mr. PICKETT. Not on that issue. The Federal lawsuit deals with the recoverability of the procurement costs. I can explain that if you would like. It is not related to the recharacterization issue.

Mr. OSE. It predates—your Federal lawsuit predates the recharacterization. We may well have a second lawsuit as a function of recharacterization?

Mr. PICKETT. Yes, sir. If our memorandum of understanding is not implemented, we have reserved the right to pursue our remedies in this regard.

Mr. OSE. Now if you prevail on either the first or the second law—no, you do not have a second. You have a first lawsuit, the existing lawsuit. Actually you have agreed to set that aside in the course of the transmission, so maybe my question should be directed to Ms. Hapner.

Are you a party to this lawsuit? Is PG&E a party to this lawsuit?

Ms. HAPNER. We also have a Federal filed rate doctrine case with the Federal court.

Mr. OSE. Similar circumstances?

Ms. HAPNER. Well as Mr. Pickett said——

Mr. OSE. Over procurement costs recovery?

Ms. HAPNER. Yes, that those are legitimate—those costs were approved by the Federal Energy Regulatory Commission; therefore, we are allowed to pass those costs through to our customers.

Mr. OSE. Were they approved by the PUC?

Ms. HAPNER. Our claim and the basis for our case is that these are wholesale costs.

Mr. OSE. So they would be Federal?

Ms. HAPNER. Right.

Mr. OSE. And the PUC does not have any input or review or what-have-you over that particular aspect?

Ms. HAPNER. That is correct. The PUC has challenged that case.

Mr. OSE. OK. I want to shift my focus just a little bit now. Yesterday I asked this question at least five times, having to do with whether or not there are any standards in existence at the PUC to give you direction as to what is reasonable or unreasonable in terms of forward contracts you may wish to enter into. I was told very directly that the PUC has finalized that rule five times. I am asking today, do you have any document such as this, which is a PUC printed—actually this is California Energy Markets, but it looks pretty official, so we are going to wave it around a little bit. Something of this nature, like we would have in the Federal Register for any agency ruling. Do you have anything from the PUC that in fact is final regarding what is reasonable relative to long-term forward contracts that you may wish to enter into?

Mr. PICKETT. No, sir.

Mr. OSE. None?

Mr. PICKETT. No, sir.

Mr. OSE. That is 180 degrees different from what we were told yesterday.

Mr. PICKETT. The only caveat I would put on that is that the traditional standard for recovery of utility costs is that they be reasonable. The PUC has not issued, to my knowledge, guidelines that would say what is reasonable for utility procurement.

Mr. OSE. What is the standard?

Mr. PICKETT. That is our problem. That is why we sought—when we finally got authority to enter into contracts, we wanted them preapproved because there was no standard to say what is reasonable, what costs are we going to be allowed to recover. You have to have the cost recovery piece in order to enter into a viable contract and not just be incinerating money.

Ms. HAPNER. I believe that all three investor-owned utilities have submitted different criteria suggesting those be the basis for preapproval standards, and to my knowledge none of those, nor any version of any of those has been approved.

Mr. OSE. What you are trying to do is eliminate uncertainty by asking for the standards.

Mr. PICKETT. Absolutely, yes.

Mr. OSE. Apparently when the yellow light goes on my microphone goes off. That is pretty tricky. I want to go back just for a moment, and if my time expires we will come back to it. In terms of the recharacterization of the stranded costs on a 3 or 4-year after-the-fact basis, what is the consequence to the capital structure of the utilities based on what you said earlier about utilities having to maintain a certain capital structure, the reaction of Wall Street?

I knew I was going to do this. We will have to come back to this, Mr. Chairman. I yield back.

Mr. BURTON. Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

Let me ask Mr. Desrochers what he thinks the impact of the proposed 15 percent cut in renewable energy and energy efficient kind of activities would mean in terms of the California energy crisis, and also just in terms of renewable energy in general. There is a 15 percent proposed cut I believe in the President's budget, which is approximately $180 million which would be taken away.

Mr. DESROCHERS. I am not aware of that. This is a cut in the President's budget?

Ms. LEE. Right.

Mr. DESROCHERS. I am not aware——

Ms. LEE. For renewable energy activities.

Mr. DESROCHERS. Yes, I could not give you a guess at what the impact on that would be. We are proposing some legislation for a tax credit for renewable energy similar to what the wind energy industry has currently. So that would be an additional legislation. I could not address what that impact would be.

Ms. LEE. OK. What do you think a reasonable rate in terms of percentage for renewable energy should be? I am supporting 20 percent by 2020. What is your take on that?

Mr. DESROCHERS. I would agree that 20 percent would be——

Ms. LEE. You think 20 percent?

Mr. DESROCHERS. Yes. In fact, we proposed legislation about 4 years ago in California that we have a 5-percent of what we call renewable portfolio standard.

Ms. LEE. What is it now in California? Did you mention that earlier?

Mr. DESROCHERS. I said it is 2 percent.

Ms. LEE. It is 2 percent now?

Mr. DESROCHERS. 2 percent, correct.

Ms. LEE. OK, thank you.

Let me go now to Ms. Hapner and Mr. Pickett. Let me just ask you what you think the distinguishing or most important factor was in your decision to file bankruptcy and your decision, Mr. Pickett, to move forward with an MOU? I mean, what was it that caused you to go in different directions in this crisis?

Mr. PICKETT. Well, I cannot speak, of course, to the what I am sure were terribly painful judgments at PG&E that led them to their decision. For our company, we are not out of the woods. We have more bills stacked up on the desk than we have money to pay, and it is not a good situation to be in obviously. As this crisis has developed, we have struggled mightily to maintain our levels of customer service and keep our employees working and calm and focused on the job that needs to be done. We continue to believe, even as we are hanging on the edge by our fingernails here, that a negotiated solution, if one can be reached and implemented, is preferable to the lengthy process that bankruptcy will involve. It is preferable for the State to have its policymakers in control of the utilities going forward rather than a Federal judge. It is in everyone's interest to get the utility credit-worthy, because as several of the panelists have commented, billions of dollars of investment are required in California infrastructure over the next few years. Path 15 is one example.

We have not shorted our utility in terms of the investment that it needs, but a bankrupt utility cannot put that kind of money into the infrastructure. It just simply cannot do it, the money is not there. So we believe that a negotiated workout that will quickly get the utilities back to a credit-worthy status where the critical investment in infrastructure can be made, where we can keep our employees on the job and we can continue to provide the quality customer service is the way to go. Ms. Hapner, of course, will address PG&E, but I have to tell you we are not out of the woods and we are hanging on the edge.

Ms. LEE. So you have more debts than assets. Clearly bankruptcy is a remedy in those circumstances, but you chose to try to negotiate your way out of it?

Mr. PICKETT. We have chosen this far—and thus far is the critical phrase—to try and negotiate our way out of it. We have 14 or 15 lawsuits from QFs now seeking back payment. We do not have the money to pay even if they got their judgment. We have more bills stacked up on our desk, back bills, than we have money to pay. We have got to find a negotiated solution and we have to do it quickly because our creditors, the people who have invested in this business, our bankers have legitimate expectations of being paid and their patience is not infinite.

Ms. LEE. So, Ms. Hapner, was bankruptcy the easy way out?

Ms. HAPNER. Anyone who thinks that a decision to go to the bankruptcy court for protection is the easy way out, particularly for a company that's over 100 years old, does not understand just how difficult this decision was, Ms. Lee. Let me just say the only thing that separates our two utilities—we are both facing mounting debts and we both have faced a series of very destabilizing actions from the Public Utilities Commission. We did not feel that sufficient progress was made on a comprehensive solution. I was not part, and I am not part, of the utility negotiating team that worked with the State. But it is my understanding that those negotiations have been very complex and they have been very honest, but they have not moved forward as quickly as we would have hoped. In the meantime, it was very clear that the State did not assume the full procurement obligation that we had hoped they would, meaning that every month we are incurring over $300 million more of generation debt, which, of course, then is—our inability to pay, as Mr. Pickett said, has impacted our ability to pay our qualifying facilities. Our ability to make our commercial paper debts and thousands—literally thousands of vendors that we have quite inadvertently brought into this situation with us. So it is the lack of progress, and in the midst of that lack of progress the actions by the Public Utilities Commission, including the change in accounting that Mr. Ose was pursuing, that led us to believe that the quickest and the best way to get to resolution was to move to the Federal courts.

Ms. LEE. Thank you for your candor.

Thank you, Mr. Chairman.

Mr. BURTON. Thank you, Ms. Lee.

We are going to do one more round. I know that you are probably getting a little tired of sitting there. Do any of you have to take a break real quickly or can you sit there for another 25 minutes? If you can, then what we will do is, we will start our final round and after we conclude this round, if we still have questions we will submit them to you. And if you will kindly give them to us for the record would be helpful, OK.

OK, let me start this final round by saying, Mr. Vanech, how many megawatts of power of qualifying facilities are idle right now because they are not being paid?

Mr. VANECH. As I understand it, there are—out of the gas-fired projects totaling 5,200 megawatts, I understand 3,000 are now shut down.

Mr. BURTON. 3,000 megawatts are shut down?

Mr. VANECH. That is my understanding. I believe this is current as of April 2nd. That is the information I got.

Mr. BURTON. Would your company prefer the ability to sell electricity in an open market?

Mr. VANECH. Let me answer that in two ways. With respect to the existing QF facilities we have, our preference would be to sell under our existing contracts, because our existing contracts are long-term agreements and we have lived up to our end of the bargain and what we want is our customers to live up to their end of the bargain.

Mr. BURTON. But you have not been paid?

Mr. VANECH. No, we have not been paid; therefore, in turn, we cannot pay our fuel suppliers who will not give us gas.

For new projects—and we, by the way, are trying to get a project off the ground for 200 megawatts. The first turbine would start delivering energy in last September of this year in California. We have to make a decision as to which way we are going to go. We have basically three options. We can sell to the Department of Water Resources under their procurement plan. We can enter into an agreement with a third party such as an El Paso or a Shell, one of the large energy companies. Or we can try to essentially go it alone and sell into the market. The first two are sort of simple because they are going to be long-term contracts and we essentially are going to lay the risk off—the market risk to somebody else.

The problem is there is really no market now that exists in California. The PX, obviously, was discontinued or terminated, however you want to characterize it. So there is really no transparent market to buy and sell power and trade power in the State at this point. I think it would be extremely beneficial—and I realize that after terminating the PX, I am sure no one has the appetite to start it up tomorrow. But I think there needs to be a realization that in order to have an effective transparent open market, there has got to be a way to trade the commodity. So I think longer term some sort of open market needs to be reintroduced.

Mr. BURTON. So if you had your druthers it would be an open market?

Mr. VANECH. Yes.

Mr. BURTON. What would be the result if the QFs were freed from their contracts with the utilities?

Mr. VANECH. I believe the QFs for the most part would be able to come back on line. The reason we would be able to come back on line is, the large energy companies, such as the El Pasos of the world, who I mentioned earlier, we believe would be willing to pay us a fee to convert natural gas into power, and they essentially would sell that power for us. It eliminates the current credit issue. Our balance sheets do not look very attractive right now since we have huge liabilities and in most cases little or no cash. But what they will do is essentially deliver gas—they have title to the gas—and we in turn deliver them electricity back. In other words, we convert the gas to electricity and in exchange they will pay us a fee for that service.

Mr. BURTON. So if you could get out of your contracts you would jump at that in a heartbeat?

Mr. VANECH. Absolutely. Different QFs have different views. We are not seeking at this point to terminate our contracts.

Mr. BURTON. I understand, but you are not getting paid.

Mr. VANECH. Exactly. We need the right to suspend these contracts, that is correct.

Mr. BURTON. Have you gone to court or anything to try to suspend the contracts because of nonpayment?

Mr. VANECH. We have. We started by actually sending a letter to Edison for the four southern California projects asking for relief, but we did not get a response. We then, more recently, filed a lawsuit in Los Angeles County, on behalf of our four projects, asking the court to give us the relief. And this past Monday the California

Cogen Council, of which we are a member filed a petition in front of FERC asking FERC to give emergency relief to allow the QFs to sell to third parties. To my knowledge, nothing has been done, at least as of this time.

Mr. BURTON. Well, I do not see how anybody in good conscious could say you have to go bankrupt when you have an opportunity to find another market that will keep you afloat. It does not make any sense.

Mr. VANECH. I agree.

Mr. BURTON. To PG&E and Southern Cal Edison, what is your companies' position on allowing the QFs to end their contracts with utilities and sell their power on the market since you are not paying them?

Mr. PICKETT. Well, beginning this Friday—checks will go out this Friday. Under the order of the Public Utilities Commission, we will be paying the QFs going forward.

Mr. BURTON. Will you be paying them all that you owe them or just a portion?

Mr. PICKETT. We will be paying all of the QFs that are on line. These are output contracts. So all of the QFs that are delivering in April will be paid beginning—and the checks will go out on an advanced basis this Friday.

Mr. BURTON. So that will be for the total amount that is owed?

Mr. PICKETT. No, no, sir. I am sorry. It is for the going forward amount beginning—I have forgotten whether the date is March 27th or—it is basically for April forward we will be paying the QFs. Hopefully, if we have enough money on an ongoing basis—on a current basis, there still is a past debt owing.

Mr. BURTON. Excuse me, but are the arrearages necessary for you folks to be able to continue to move on? I mean, if they start paying you in full.

Mr. VANECH. The answer is, I believe our gas suppliers will work with us and start supplying gas again to start back up, assuming there is a clear path to us getting paid, and to know that we are actually going to get paid. Just saying that, you know, at some point in the future we are going to get paid I do not think works. I think that most of the QFs have flexibility with respect to some sort of suspension, if you will, of this amount owed from the utilities. But there needs to be a clear path so we can turn around to our fuel suppliers principally and say OK, you can be comfortable now because we are going to get paid X dollars over a period of time, and this is a credit-worthy obligation, so we know in fact that there is going to be money to get paid. That is what we require.

Mr. BURTON. Do you need the arrearages in order to keep those suppliers happy?

Mr. VANECH. It is a mixed bag. We have three different fuel suppliers. I think one will supply gas to us on the basis of getting paid currently, assuming we can reasonably demonstrate an ability to pay them off over time. The other two I do not think are as flexible. So, I think it is company-specific.

Mr. BURTON. So you still need some relief from your contracts in order to keep things going, is that what you are saying?

Mr. VANECH. We either need relief from our contracts, i.e., the ability to suspend or not sell under the contracts, or to the extent we sell under the contracts we need two things. We need creditworthiness behind the payment so that we know we can get paid.

The second problem is, as I said in my opening statement, the current formula that was approved by the Public Utilities Commission, I think about 2 weeks ago, does not work for the gas-fired plants. The revenue—again, taking an average qualifying facility, the revenue of $80 a megawatt hour does not even come close to covering the fuel cost of about $140 a megawatt hour at today's gas prices. So it is totally uneconomic for the gas-fired plants to run today until the Public Utilities Commission, or some other body, changes the formula to be consistent with the Federal and State law. Right now that formula is inconsistent with Federal and State law and that is one of the arguments or causes we are going to FERC to seek relief on, that this formula does not work and is just wrong.

Mr. BURTON. Let me get on to another subject here. Yesterday Ms. Lynch testified that both of your companies did enter into some long-term contracts last summer after the Public Utilities Commission issued its August 3rd order. You have testified to that effect today. Will each of you provide us with documentation of all the forward contracts you entered into during that period? That is after the PUC gave you authority to do it in July 2000.

Mr. PICKETT. Yes, sir, we are pleased to do that. We entered into five contracts for 350 megawatts. When you say documentation, we would just like to be clear on what it is you want. We can give you the contract itself or whatever else we have.

Mr. BURTON. We would like to have a copy of the contract, if we could. The Public Utilities Commission said yesterday that we had to get permission from you to get this information. They would not give it to us. So we would like to have the contracts. Can we get them for you as well?

Mr. PICKETT. Let me say there may be confidentiality provisions in those contracts. If we cannot provide them for that reason, we would provide them pursuant to a subpoena from the Commission.

Mr. BURTON. Well we will send you a subpoena if it is required. So you just tell us what is necessary. We do not plan to divulge this information publicly, but it is something that we need to take a look at to see what, if anything, we can do to be of assistance at the Federal level.

Mr. PICKETT. I understand. For our part, we would be pleased to provide whatever material we have, subject only to the confidentiality provisions that may have been entered into with the other party to the contract. But I would think if this committee subpoenas them they can have them.

Mr. BURTON. Would you prefer for us to subpoena them?

Mr. PICKETT. Well let us check the confidentiality provisions. I just do not know——

Mr. BURTON. We want to make sure we have got all of the facts. That is all I am saying.

Mr. PICKETT. One way or the other you will have the facts.

Mr. BURTON. OK, good. Ms. Lofgren.

Ms. LOFGREN. This has been a long day, so I will be quick. Mr. Pickett, you have been active in your legal career around energy issues your whole career, if I heard you correctly, and know a lot about FERC and the law. I am wondering if in that capacity as a witness you could comment on this question. The chairman mentioned that there had been a letter sent by nine Governors to FERC objecting to rate caps, and he was kind enough to share a copy of the letter with me. We also know, however, that the Governors of Washington, Oregon and California on March 9th asked FERC to impose price caps, and I do not believe they have received an answer to that. Now putting aside the politics of the situation, and that the founders in their wisdom made North Dakota have two Senators and California two Senators as well. Would the law allow for the feds to impose regional price caps for the Western region despite the fact the Governors of some of these small States do not like it, even though the Governors of Washington, Oregon and California have asked for it?

Mr. PICKETT. I am not sure how much I really know the law, but I have practiced in the energy area for 20 years, sometimes to my regret. I have done a number of FERC rate cases and proceedings before the FERC of other natures. My understanding of the Federal Power Act, the whole reason for it is to be sure that regional differences and inter-regional competitive pressures do not impact the public interest. I believe that the FERC—if it had the record before it, which it can surely make, it has the rules to make the record so that it can take action—can impose a region-wide price cap either on individual generators—the regulation as it is contemplated is on the seller—or it can do it region wide, either way. I believe it could do it.

Ms. LOFGREN. All right, if I can just quickly followup. I am sure that there are more users of electricity in California than these nine States put together. If nothing is done—if the FERC—what did they say, market—what was the phrase they used this morning? Mitigation plan proves to be puny and not very helpful and we end up with this price control situation that is completely out of hand, do you believe that the States of Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, North Dakota, Utah and Wyoming will not also be caught up in the rapid price escalation and crazy market that has developed here in the West?

Mr. PICKETT. I believe they already are with the possible exception of North Dakota.

Ms. LOFGREN. It is under water right now.

Mr. PICKETT. Well most of the Western States are interconnected in a grid, but are not connected to the Eastern half of the United States on a line that runs roughly East of the Rocky Mountains. There is very limited interconnection there. I think North Dakota is on the Eastern side of that. But with that exception, I think that the Western States, like it or not, are going to rise together or fall together here. The market impacts and certainly spreads to nearby States in California and—or spread to the Northwest and are certainly likely to spread elsewhere if the situation is not corrected. Now having said that, I should say that a number of these States have not deregulated their markets and the effect of that is very, very important when you talk about caps and the percentages and so forth. A State that is not deregulated and has utilities operating as a vertically integrated monopoly is providing most, if not all of their power, from rate-based regulated generation. They are not in the market, or if they are in the market, it is for a very, very tiny percentage of their power. Sure, they may be willing to pay a huge amount for that little tiny increment. In California, we are paying that huge amount for the whole thing and that is what is crazy. We have got to stop that. That can be stopped.

Ms. LOFGREN. And is that why, in your judgment—I will not ask you to speculate what the Governors were thinking, but why it would be in the interest of the State of Washington and Oregon to join with California on a request for cost-based price caps to FERC?

Mr. PICKETT. In part—and I have to hedge the answer because the regulatory situation—the extent of deregulation in each State is different, and the supply and demand situation in each State is different. As a general matter supply is tightening up. As I said earlier, it is not all a supply and demand problem, but clearly in the summer, in the peak months—in southern California the peak months are in the summer and there is a supply shortage. In the Northwest the situation is reversed. It is a winter shortage, or it is a winter-time peaking and therefore a shortage problem. Supply is tightening up there as well. So you have to be careful and look at the inter-regional factors, but in general the answer is yes.

Ms. LOFGREN. Thank you.

Mr. BURTON. Thank you, Ms. Lofgren.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

On the issue of the recharacterization and its impact on your financials, I am going to ask you to respond to that in writing because I do want to ask these fellows a couple of questions.

I want to make sure I understand as it relates to the QFs the impacts in the valley. In Sacramento and its surrounding area, we are a severe non-attainment region regularly and San Joaquin is on the verge of being characterized or classified similarly. So in effect, a vast majority of the central valley will then be on a non-attainment basis. My understanding of the QFs is that they provide power that has a far lower level of emission into that geographic area than say a more traditional type of power generating infrastructure, is that correct?

Mr. DESROCHERS. Yes, that is correct. And not only that, the material that we utilize normally is open-field burned, which is still permitted in the Central Valley. We take that material and use it for fuel in a controlled combustion atmosphere and reduce the pollutants by 96 percent of what would have happened if it was burned in the open fields.

Mr. OSE. So it is very environmentally friendly?

Mr. DESROCHERS. Yes.

Mr. OSE. Is that the same with you, Mr.—is it Vanech?

Mr. VANECH. Vanech. Yes it is directly resultant from the age of the plant typically. But since the QFs tend to be 10 or 12 years old and have to comply with the best available technology, most of them have selected catalytic reduction on the back end, which means the No_x emissions are generally in single parts per million. All that means is that they are very clean plants, simply put.

Mr. OSE. Now the decision recently by the PUC to reduce the compensable level for the IER from 11,000 plus to 9000 plus in effect says—if I understand correctly—that you are only going to be compensated for using enough—in terms of your recoverable costs or your rate, you are only going to be compensated for the costs that would get you up to an IER of 9140 BTU, whereas it might take you 11,000 to get to the appropriate level so that your facilities run?

Mr. VANECH. That is exactly correct.

Mr. OSE. OK.

Mr. VANECH. In fact, the rate is actually supposed to represent an incremental energy rate. Just by comparison, the average energy rate, which is far below the increment, for Edison over a 20-year period we calculated it about 9,900 or 10,000. So not only is that 9,100 way below an incremental energy rate, it is actually below the average rate.

Mr. OSE. Now you have facilities in the Central Valley. Mr. Vanech, do you have facilities in the Central Valley? You said you have five in California, four in Los Angeles?

Mr. VANECH. And one is at UC-Berkeley serving the State.

Mr. OSE. OK. LA has got air quality problems regularly. The question I have is that to the extent that the QFs, who were originally developed under PURPA, as I recall—to the extent that the QFs cannot recover cost, they are going to shut down or they are going to reduce operations.

Mr. VANECH. Absolutely.

Mr. OSE. So my question is, because—I mean, I have to tell you between the health and safety of young people—I should say the health of young people, the health of older folks in the valley, our ability to have clean air, it would seem to me that the arbitrary decision to reduce the IER from 11,000 to 9,000 is a direct attack on our environmental quality, because it makes it less economical or less possible for you folks to operate. I mean if you just connect the dots.

Mr. VANECH. Yes.

Mr. DESROCHERS. Yeah, you have come to the right conclusion, that is correct.

Mr. OSE. The thinking behind the decision by the PUC is found—what is the fundamental logic?

Mr. VANECH. I will speculate that it is based on political pressure to lower the rates. I mean, it clearly contradicts Federal and State laws, PURPA laws. I can only imagine that it is politically motivated in a desperate attempt to lower rates.

Mr. OSE. Is there anything we can do at FERC to reverse this?

Mr. VANECH. We have filed a petition, effective as of Monday, to ask for relief at FERC, yes.

Mr. OSE. And the basis on which you are doing it relates to PURPA or to the fact that maybe your electrons travel interstate?

Mr. VANECH. Strictly as it relates to the rules of PURPA, because the formula now violates Federal and State law.

Mr. OSE. How many folks work at your plant, Paul?

Mr. DESROCHERS. Statewide we have 100 folks and then we have indirect employees of right around 400.

Mr. OSE. Mr. Vanech.

Mr. VANECH. We have about 65, including management and operators.

Mr. OSE. You testified earlier that the natural gas that you get is provided to you by third parties.

Mr. VANECH. Yes, that is correct.

Mr. OSE. And it is on a spot price basis?

Mr. VANECH. It is.

Mr. OSE. And you return the electricity based on a factor above and beyond the cost of natural gas. In other words, you take the natural gas and you produce the electricity and you sell it back to the guy?

Mr. VANECH. Exactly.

Mr. OSE. OK. My time has expired, Mr. Chairman.

Mr. BURTON. We will go to Ms. Lee and then we will come right back to Mr. Horn who can yield to Mr. Ose if he so chooses—what a nice fellow you are. Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman. For the record, let me just indicate that it was brought to my attention that on March 22, 2001, Dr. Alan Lloyd who is the chair of the California Air Resources Board, he actually testified in front of the Subcommittee on Energy and Air Quality of the House Committee on Energy and Commerce. His quote was it can be said with certainty that environmental laws are not to blame. I just want to make sure that is in the record.

Let me just mention this, and then I would just like each of you to respond very briefly. Some say that the only way out of this crisis is actually through re-regulation. Price gouging was not as evident when utilities were regulated and utility bills were much lower. So I guess I want to ask each of you, which regulatory or which nonregulatory environment worked best for the consumers, for the utility companies and for the generators? Ms. Hapner and each of you. I would like to hear your take on that, because many people are saying that it was better before, and there is evidence that at least consumer costs were much lower. We did not see the evidence of price gouging, even though it may have been occurring.

Ms. HAPNER. I agree that this has definitely turned into a deregulation versus regulation debate. We still think that a correctly structured market could work. It is certainly working in other States. I think in retrospect, all of us who were part of this process—and I worked on the restructuring—on proposals for the last 7 or 8 years. All of us involved made a series of compromises in order to get the kind of legislation that would be unanimously passed, which it was. In retrospect—and certainly it is always easy to do this in retrospect—the way that the market was structured was designed to fail. Obviously we did not do that intentionally.

It is very easy to be critical right now of one or all of the parts of the electric restructuring that we took on in California. Admittedly, we are California, we are an easy target for others. But knowing what we know now about how to establish the market, knowing what we know now about the impact of supply and demand and the record growth that we faced, we clearly could have done a much better job of restructuring this market.

Mr. PICKETT. I share all of those comments and would now look to the future and say we need to do two things, in my judgment. As I said in my opening comments, the first thing we have to do is take the time out and fix this thing so that we can fix it while customers are not being gouged. We just have to stop this. The market does not work. But beyond that, I think it can be fixed. There are electricity markets around the country that work.

We believe that generation is probably best provided in a competitive market that is workably competitive, that provides the kind of price restraints that competitive markets provide and provides the kind of rigor that best allocates capital to the most efficient projects that wind up benefiting customers.

But we are faced with a real crisis here and we cannot just wish away that crisis and rely on the ideology of getting to the workably competitive market to carry us through the next 2 years.

Ms. LEE. Mr. Vanech.

Mr. VANECH. It is my strong view that a correctly functioning deregulated market is the best situation for everyone. PJM, Texas, you can look to those markets, they really work pretty well and people have actually saved money.

The other big issue I think is utilities need the ability to create a balanced portfolio of energy purchases. What that means is, it should not be all long term and it certainly shouldn't be all short term, as evidenced by California. It is like any other investor putting a portfolio together, not everybody buys high tech stocks presumably and not everybody buys only bonds. There has got to be risk and reward and an understanding by the regulators that long-term contracts from time to time may be more expensive than short-term alternatives, but on the other hand, they are also going to be less expensive at certain times. So I think there needs to be a balanced portfolio approach.

I think the other thing I would add is there needs to be a clear way for developers to come in and actually get things done. That means both from a regulatory perspective and from an environmental perspective there needs to be a clear path to get projects built. Nothing will scare a developer away who is putting millions and millions of dollars at risk before we ever know we have a project if we cannot see—knowing if we follow the rules and go down the correct path, that—you know, we do what we are supposed to do, that we can get a project put together. That is what needs to be done. There needs to be confidence in the market for people to commit significant amounts of capital. Again, if you go back to Texas and go back to PJM, just to take those two markets, significant amounts of new capacity have been added over the last 2 years and continue to be added because people feel that if they put their money in the market there is no guarantee of return certainly, but at least there is an assurance that there will be a fair process in the market.

Ms. LEE. Mr. Chairman, can we have 30 seconds to hear Mr. Desrochers' response.

Mr. BURTON. [Nods.]

Ms. LEE. Thank you very much.

Mr. DESROCHERS. I would echo the statements and the comments that the other panel members stated. I would just add one more statement, in that I do believe that we need a comprehensive National and State energy policy that would include a focus on renewable energy. That is all.

Ms. LEE. Thank you very much.

Mr. BURTON. Mr. Horn.

Mr. HORN. I am going to ask one question and then turn it over to Mr. Ose. I am fascinated by the two gentlemen's testimony, and I wonder, since every group in America always has an office in Washington, DC, and the QFs that do all of these good deeds, is there a national group in Washington speaking for you?

Mr. VANECH. I think there used to be and it merged with a group known as EPSA, that you may be aware of, Electric Power Supply Association, and that group tends to represent generators. I am not aware of a specific QF industry group.

Mr. HORN. How many units are there in the Nation similar to yours? Are we talking 10,000, 5000?

Mr. VANECH. If I had to guess, I would say—boy, that is a tough question. I would just hazard a guess and say maybe 1,000 to 2,000. I might be on the high side.

Mr. HORN. It is very interesting that you can be the balance wheel here and solve some of these problems.

I now yield the rest of my time to the gentleman from California, Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

I have just a couple of simple, straightforward questions and they are based on a concern that our colleagues in other States not have to experience in their States what we are experiencing in ours. My question is, if other States are looking at a deregulation—quote, deregulation proposal, would you recommend that those States allow utilities, IOUs, QFs, whatever, the ability to enter into long-term contracts without undue after-the-fact review? In other words, my question is, should those other States give their power companies the option—not the mandate, but the option of entering into long-term forward contract deliveries? The second question is whether you would suggest to those other States allowing generators direct access to the marketplace? In other words, the ability to sell not only here but there. Ms. Hapner.

Ms. HAPNER. I think if I was advising another State on how to go forward or in the alternative how to do things differently, I would first of all not require that the regulated utilities buy and sell from only one market.

Mr. OSE. I need——

Ms. HAPNER. I am getting to——

Mr. OSE. I do not have a lot of time here. I have four people I want to ask this question.

Ms. HAPNER. OK. Yes, they should be able to contract in the market with clear standards ahead of time, so that down the road they shouldn't be second guessed for their decision.

Mr. OSE. If there are other suggestions that any of you have beyond the two questions I have, we would be happy to take those in writing.

Ms. HAPNER. Great, I will do that.

Mr. OSE. Now you would support—if other States are considering restructuring, your advice would be to allow the utilities in their States to engage in long-term forward contracts without undue reviews or second guessing or however you want to describe it?

Ms. HAPNER. Without undue review after the fact. I think it is quite appropriate before the fact to lay out criteria.

Mr. OSE. OK. Mr. Pickett, would you agree with that?

Mr. PICKETT. Yes, sir.

Mr. OSE. OK. Mr. Vanech.

Mr. VANECH. Yes, fully. In addition, I might sort of propose that the committee consider resurrecting the original intent of PURPA. One thing PURPA did is it got a lot of new plants off the ground, and the reason it did is because utilities were able to enter into long-term contracts. I will keep it quick. Basically the generator knew they could recover their capital.

Mr. OSE. As to the PURPA question, I would be happy to take your other suggestions in writing.

Mr. VANECH. The answer is yes then.

Mr. OSE. Paul.

Mr. DESROCHERS. Yes. The answer is yes.

Mr. OSE. OK. On direct access, is that a tool other States ought to allow their generators—their intrastate generators to utilize?

Ms. HAPNER. I apologize, Mr. Ose, but I am not sure I understand what you mean by direct access.

Mr. OSE. OK, let me just cite an example. Let us say that Mr. Desrochers' plant has the opportunity to contract in a new market environment with any number of people rather than being forced to sell to a single point of purchasing. Is that something that would help this?

Ms. HAPNER. I think that all the markets work better if they are unfettered. I do think though that where contracts already exist between two parties, they need to be respected.

Mr. OSE. Bilateral contracts?

Ms. HAPNER. Yes.

Mr. OSE. OK. Mr. Pickett.

Mr. PICKETT. Fundamentally I think that direct access, by which I take it to mean generators selling directly to other retail customers, is not a useful tool in the long run because the market is not one in which choices—the product is fungible. There are not a lot of choices that can be made.

Mr. OSE. What about wholesale?

Mr. PICKETT. At wholesale there should be an open market. I think to allow unfettered direct access allows the big users to cream skim and the small customers and the residential customers wind up bearing the burden.

Mr. OSE. But you would support wholesale direct access?

Mr. PICKETT. Wholesale, yes, sir.

Mr. OSE. OK. Mr. Vanech.

Mr. VANECH. Yes, anything to enhance liquidity will increase the supply and should actually make prices better—lower.

Mr. OSE. Do you think the solution—I mean, you suggest supply is—I am going to ask you a question in writing—and you can respond to it—on the supply and demand issue.

Paul.

Mr. DESROCHERS. Yes, I would agree with wholesale direct access.

Mr. OSE. Mr. Chairman, I want to come back to something Congresswoman Lee said, and I heartily agree with her. I have said this time and time again. This is not a question of California's environmental standards being too tough, and I will tell you why. The technology that is available today to convert natural gas to electricity, as an example, is 50 percent more efficient at that conversion with emission levels 25 to 50 percent below technology that was developed as recently as 8 or 10 years ago. We can bring on line plants that take that same amount of gas and instead of creating 10,000 megawatts, create 15,000 megawatts with 25 to 50 percent fewer emissions. The consequence of that is, if we would expedite siting licensing and allow the supply to come on line, we would have a temporary uptick, as you would expect, in emissions, but as those new plants come on line the old plants would fall from a base position in the load to a standby or peak load and that curve would come down on the emissions. So I agree with Congresswoman Lee. I have been beating my brains out trying to get that message out and I just wanted to reinforce it.

Ms. LOFGREN. Would the gentleman yield for just one comment.

Mr. OSE. Subject to the chairman's discretion.

Ms. LOFGREN. Just in support of your statement and Congresswoman Lee's, although no one is thrilled about it, practically every large user of electricity in this valley that I know of has backup generators that are diesel. When those diesel generators get powered up this summer, as they inevitably will, the air quality will be severely impacted. So everybody really wants these cleaner plants to be approved and built as quickly as possible.

Mr. BURTON. I want to thank you for your diligence and your patience and your ability to sit there that long.

I would just like to say that the last series of questions that Mr. Ose put to you, every one of you were in favor of free market principles and that flies in the face of the price caps you were talking about. So I presume you want the price caps removed as quickly as possible once this crisis is over, is that correct?

Ms. HAPNER. That is correct.

Mr. PICKETT. Yes, as long as we take the time to get it right next time.

Mr. BURTON. OK. Do you all agree with that?

Mr. VANECH. Yes.

Mr. DESROCHERS. Yes.

Mr. BURTON. I want to thank you very much. I want to thank my colleagues and our colleagues who are not members of the committee for spending your time with us today. You were very helpful. Thank you very much. We stand adjourned.

[Whereupon, the committee was adjourned at 2:15 p.m.]

ASSESSING THE CALIFORNIA ENERGY CRISIS: HOW DID WE GET TO THIS POINT, AND WHERE DO WE GO FROM HERE?

THURSDAY, APRIL 12, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON GOVERNMENT REFORM,
San Diego, CA.

The committee met, pursuant to notice, at 10 a.m., in the County Board of Supervisors, 1600 Pacific Highway, room 310, San Diego, CA, Hon. Dan Burton (chairman of the committee) presiding.

Present: Representatives Burton, Horn, Ose, Hunter, Filner, and Davis.

Staff present: Caroline Katzen, professional staff member; Robert A. Briggs, chief clerk; and Elizabeth Mundinger, minority professional staff member.

Mr. BURTON. If I can get everybody to take a seat. Can you hear me all right? Is this mic on? If everybody could take seats, we could close the doors.

Good morning. A quorum being present, the committee will come to order. I ask unanimous consent that all Members' and witnesses' written opening statements be included in the record, and without objection, so ordered.

I ask unanimous consent that all articles, exhibits, and extraneous or tabular material referred to be included in the record, and without objection, so ordered.

I ask unanimous consent that Members of Congress who are not members of the committee be allowed to participate in today's hearing, and without objection, so ordered.

I ask unanimous consent that all questions submitted be in writing to the witnesses, and their answers be included in the hearing record. I ask unanimous consent that questioning in this matter proceed under clause 2(J)(2) of House rule 11 and committee rule 14, in which the chairman and ranking minority member allocate time to members of the committee as they deem appropriate for extended questioning, not to exceed 60 minutes equally divided between the majority and the minority. And without objection, so ordered.

I want to welcome the members of the committee who are here with us today: Congressman Ose, who is from up North, around Sacramento; and Congressman Horn who are both subcommittee chairmen on our committee. Congressman Horn, is from the Long Beach area. We also from this region have Congressman Duncan

Hunter, Congressman Filner, and Congresswoman Davis. And we appreciate you being here and participating in the hearing today.

I want to welcome everyone to our third day of hearings on the energy crisis here in California. I want to say a couple of things about why we are here. We came here because we want to play a constructive role in the crisis. We did not come to point fingers at anybody. We came to listen and learn. We want to see if there are ways the Federal Government and the State government can work together to get past this crisis. But first we need to understand the problems.

This summer, Congress is going to have a serious debate about our country's energy policy. It is a debate that is long overdue. Energy policy has been neglected for far too long. On the Government Reform Committee we have been holding hearings to prepare for this debate. We study our oil and gasoline markets. It is very clear that we need to have more domestic production to reduce our reliance on OPEC.

It is clear that we need to have more refinery capacity to avoid the kind of disruptions that we had in the Midwest last summer. We have studied the problems in the natural gas markets. America has abundant supplies of natural gas, but prices are skyrocketing because those reserves are off-limits.

Today we have the technology that makes it environmentally safe to drill for natural gas. As demand keeps growing, we must increase our supplies. This week we are focusing on electricity. If you want to learn about the problems in our electricity markets, then you have to come to California.

We have tried to look at this problem from every angle. We have heard from State regulators. We have heard from the Federal regulators. We have heard from the major utilities. And today we will hear from the generators.

As we have gone through this process, one thing has become very clear to me. When you boil it all down, the root problem here is supply and demand. One of our witnesses in Sacramento was an independent energy analyst. He told us that over the last 5 years, California's economy has grown by about 32 percent. But at the same time, energy generation in the State actually went down—it fell. A major new power plant has not been completed in this State in the last 12 years. The head of the ISO told us that he expects to have a 3,000 megawatt shortage during peak periods this summer, and that is very serious.

Everyone agrees that more generating capacity is needed. But that is going to take time. The question is: How do we manage the situation in the meantime? Some people say price caps are the answer. My concern is that price caps for California may cause power to be diverted to other States where sellers can get better prices. Three out of our four energy experts who testified in Sacramento said that if FERC reimposed price caps it would lead to more blackouts this summer. Out of 11 Governors of the Western States, 8 are opposed to price caps on the Western grid. What is more, the Washington chairman of the FERC testified yesterday that they only have jurisdiction over about 25 percent of the electricity sales in California. If they impose rate caps on the 25 percent, the electricity will flow to the other 75 percent where prices are not capped. So I do not think that price caps are a panacea.

We have also had a running debate about long-term contracts. The press has reported that the Public Utilities Commission last summer blocked the major utilities from entering into long-term contracts that would have saved billions of dollars. On Tuesday we heard from the president of the Public Utilities Commission, Loretta Lynch. She insisted that the PUC did everything necessary to allow the utilities to enter into long-term contracts. She went so far as to say that they published final guidelines that gave the utilities everything they needed.

Then yesterday we questioned officials from Cal Edison and PG&E. It was like night and day. They told us that there was no way that they could enter into those contracts under the PUC's rules. Mr. Pickett, from Cal Edison, said it would have been like incinerating or burning money. They said that to this day the PUC has not published the guidelines that are needed. Now, this is very disturbing. The general counsel from FERC talked about long-term contracts on Tuesday. He said that if San Diego Gas & Electric had entered into a long-term contract a year ago, they would have saved roughly $5 billion last year. SDG&E will be testifying today.

Today we are going to focus on the power generators. We have representatives from Reliant and Williams testifying today. As prices have skyrocketed, the generators have been accused of profiteering and price gouging. Today they will have a chance to defend themselves, and talk about why this market is not working like it should. Williams and their partner, AES, have been accused of manipulating the market last year. The Federal Electric Regulatory Commission said they intentionally prolonged the shutdowns of two of their units where they were obliged by contract to provide electricity at a lower rate. As a result, electricity had to be purchased from two other AES units at 10 times the cost. FERC has ordered them to repay $10 million. We are going to have a lot of questions about that case today.

On our first panel we have several distinguished businessmen from the San Diego area. As we all know, San Diego ratepayers have been hit harder than anyone across the country this year. We want to hear from them, how that has affected their competitiveness. We also have added one new witness, Mr. Gregory Conlon. He was the president of the Public Utilities Commission under Governor Wilson. At our first hearing, the current president, Loretta Lynch, had a number of criticisms of her predecessors, and Mr. Conlon is here to respond. I believe we have added one other person, Mr. Bill Horn, to the first panel. He is the chairman of the San Diego County Board of Supervisors.

Before we get to our first panel, I better allow my colleagues to say something. So why do I not start with you, Mr. Filner. Do you have an opening comment you would like to make?

STATEMENT OF HON. BOB FILNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FILNER. I thank the chairman for the courtesy of appearing with him on the committee. I thank you for coming to San Diego, which is ground zero, really, in this energy crisis. I am glad to have

Mr. Horn, who is the chairman of our Board of Supervisors. You are sitting in his chair, Mr. Chairman.

Mr. BURTON. It is a very comfortable chair.

Mr. FILNER. And unfortunately, in San Diego we just had another deadly shooting yesterday, so we are very sensitive about these issues here in San Diego.

As I said, you are at ground zero of our crisis. Last summer San Diego was the first area, in fact, the only area in California, to have complete deregulation of both our retail and our wholesale prices. What occurred there, Mr. Chairman, was a disaster, and disaster quickly. Within the first month of deregulation, bills had doubled for businesses and for individuals. Within 2 months they had tripled. And there was no end in sight, and no explanation. Can you imagine, Mr. Chairman, a small business person who was paying $800, faced with a bill of $2,500? Can you imagine a person on fixed income paying $50 or $60 a month, all of a sudden up to nearly $200 a month? There is no way people can survive in this situation. There was no way that we could continue.

A revolution broke out here, Mr. Chairman. This is a very conservative county. And yet very conservative school boards and city councils tore up their utility bills. There were rallies. There were demonstrations. And, in fact, the State put a temporary cap or a deferred cap on our retail prices which said we will stem the bleeding, but you will have to pay in the future.

Now, why did that occur? The demand was not any more than the summer before. The temperatures were not any hotter. It was clear, Mr. Chairman, that this was, at root, when it started here in San Diego, not a supply and demand problem, but a manipulation of the market by a group of people who had control over the energy coming into our area and into our State.

Prices had no relation to cost, no relation to supply and demand. And I will tell you, Mr. Chairman, that when we asked the Federal Energy Regulatory Commission to investigate the sudden rise in prices in San Diego, they did investigate. And what did they find? That prices were unjust and unreasonable! In fact, under the Federal Power Act, that means they were illegal. FERC found the prices that California was paying to be illegal. And yet they did nothing—they did absolutely nothing. And what they did, by their inaction, was to say to the energy cartel, who we will have members here today before us, “Go rob the State blind.” That is what they said to this energy cartel. And boy, did they rob the State blind.

You know what we are paying, Mr. Chairman, for energy; we are paying over $2 million an hour, maybe $3 million. Up to $50 million, up to $80 million a day, almost $2 billion a month. This energy cartel has taken almost $20 billion out of our State in the last 10 months—$20 billion was robbed from our economy. Schools cannot educate because they are paying their electricity bills. Libraries cannot buy books because they are paying their electricity bills. The guy yesterday in a senior center in my district, a half block from my office, who went on a rage, had been evicted from his apartment because he refused to pay an increase in rent, and that increase in rent, Mr. Chairman, was caused by a raise in electricity prices.

This is disastrous, what is occurring. And I will tell you we have tight supplies, and the Governor of California is doing everything he can to increase the generation of electicity. We have to conserve more, and the Governor is doing everything he can to encourage that. But the problem is the price structure. The wholesale prices are criminal. They have been found to be illegal, and we are still paying them. And it is because of the criminal prices that this is occurring.

Mr. Chairman, we have 45,000 megawatts capacity in California. The demand right now is 30,000 megawatts, because it is not the summer. And yet we had blackouts. Why? Because certain suppliers were not getting paid, and they just said we cannot supply. This is not a supply problem, it is a manipulation of the market.

And the folks that will appear before us later today have had incredible increases in profits in the last year. They have increased dramatically their ratings in the Fortune 500. They are taking the money, and they are killing off the economy of California. This threatens the West, it threatens the entire United States.

I have a bill which is supported by my colleague, Mr. Hunter and Ms. Davis, which says let us establish cost-based rates on wholesale prices, and more important, Mr. Chairman, let us refund the overcharges to California consumers and utilities. If that bill passed tomorrow, California would be made whole. We still would have to try to deal with some issues, but we would be made whole tomorrow. So I urge us to look very carefully at this legislation.

[Applause.]

Mr. BURTON. Let me just say to the audience that we appreciate your being here. At some of our hearings we have had some disruptions, and I try to tell the audience that we would like for them to be here. We appreciate their attendance. But if there are disruptions, then we have instructed the police—the Capitol Hill police and the local police and sheriff to remove those people from the room.

So we want you to stay. We want you to get as much information as possible. But it is very important that there be control of the hearing.

With that, I would like for the Members to try to stick to the 5-minute rule as close as possible. So we will now recognize Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. For brevity sake, I will submit my statement to the record.

I do want to welcome our friends from San Diego, Mr. Hunter, Mr. Filner, and Ms. Davis. I was most appreciative of Ms. Lofgren and Ms. Lee and Mr. Honda joining us in San Jose. I regret that we did not have any of our friends from the other side of the aisle in Sacramento. I have found the testimony very compelling, and to the extent that our colleagues have joined us for just today's hearing, have the opportunity to review that, I am hopeful that it will help them as much as it is helped me. So thank you, Mr. Chairman.

Mr. BURTON. Very good. Ms. Davis.

STATEMENT OF HON. SUSAN A. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. DAVIS. Thank you, Mr. Chairman. I appreciate your being here, and I appreciate the folks here, all of you here today. And I would like to share with the audience one of the concerns, of course, that we did hear about at the hearing on Tuesday night. And I regret that one of the great resources here in San Diego, the San Diego's Utility Consumers Action Network is not part of the panel or the testimony today, because I know they have been providing a vital resource to all of us, and I wanted to just acknowledge that for the record.

I do appreciate the fact that you are all here because you recognize that this is not just a California crisis; in fact, this is a crisis today that threatens our national economy. And it is important that the Federal Government take more forceful action to address the crisis. And so far it is clear that we feel that has not happened, and in fact, that the action has been sorely lacking.

I believe, and I know my colleagues believe, that the Federal Energy Regulatory Commission has failed to step up to the plate. And in determining that California is paying unjust and unreasonable prices for energy, it has, nevertheless, stepped away from its obligation to truly look at that, to truly investigate, and to determine why that is the case. It has failed to impose, as well, the cost-based rate stabilization that we think would bring about fair and reasonable prices.

I know that at last week's hearing Commissioner Linda Breathitt demonstrated a new willingness to consider some regional price stabilization, and I applaud her for her change of attitude. And I hope that FERC today—that the general counsel will dispense with a number of their philosophical statements on the beauties of this free market, and offer some useful information on FERC's legal authority to act where the free markets do not yet exist.

Again, I want to thank Congressman Hunter and Congressman Filner for their energy on this issue, for your leadership. We have met as a California delegation, and I know that we feel very focused, and we certainly want things to change. As a San Diegan, as someone here, and associate myself with Congressman Filner's remarks, as well as, I am certain, Congressman Hunter's. Because what we experienced in San Diego early on was almost a feeling of the death of a city.

And what we predicted in many cases has certainly come true. We acted responsibly here. In many cases, San Diegans actually kept the lights on for the State because of our conservation. And at the same time, we know we have to do our part. But, Mr. Chairman, we believe that there is a greater part to do on the part of our government, and we hope that this hearing is helpful to everybody in looking at those issues. Thank you.

Mr. BURTON. Thank you, Congresswoman Davis. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman, but I am going to waive my 5 minutes or whatever. Let us get down to the question and answers.

Mr. BURTON. We appreciate, as always, your brevity.

Mr. Hunter.

STATEMENT OF HON. DUNCAN HUNTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. HUNTER. Thank you, Mr. Chairman. And I thank Steve for giving me his time. Very kind of him. [Laughter.]

And do not remove anybody for laughing at that.

Mr. Chairman, thank you, as an old friend, and all my colleagues, for being here. And Mrs. Davis, Mr. Filner, for your work on this issue.

Mr. Chairman, this is a problem that really has a couple of sides to it—one, pricing; the other, supply of energy. And we did have FERC in front of us here a while back in a hearing that Mr. Barton chaired. And I pointed out, and Mr. Filner also did, that the prices at one point on the exchange actually increased. This was verified by the head of the exchange who was here. They went up 9,000 percent in a matter of minutes. Now, that is not a free market operating; that is the lack of a free market. And that was the equivalent—and that was paid and reflected in these bills across the State. That reflected the equivalent of a $200 gallon of gasoline.

And there is a statutory duty that is attached to FERC that says that they have the duty, and courts have subsequently said the duty, not the option, to reform unreasonable rates. I think a $200 gallon of gasoline is unreasonable. And they have now, somewhat belatedly and many months later, come in with orders for some fairly small refunds. But certainly you had a price gouging. When you have a 9,000 percent increase, that is price gouging, and that has nothing to do with free enterprise.

The other aspect of this that is very interesting is this, typically, if you have a bakery on your side of the street and you are charging $5 a loaf, the way the free enterprise system operates is that other people build bakeries on the other side of the street, they charge $1 a loaf, and the consumer wins. So when prices go up, typically supply goes up, because other people get in the business.

Because of a lot of very powerful political forces in California—some of them the environmental forces—we, as you have said, have not built a generating plant in some 12 years. So when prices went up and we have—basically we are in what I would call nothing short of paralysis in terms of moving quickly to build generational plants. So when prices went up in the summertime last summer, a number of people said wait until winter gets here, when we are not running our air conditioners. That means the demand will go down from about 45,000 megawatts, to about 33,000, it will go down almost 30 percent. And prices will go down.

When the winter got here and we went down, in fact, in demand by 30 percent, the generators turned to us and said you know, we have had some problems at the plant. Looks like supply just went down 30 percent, too. Supplies are still tight. Now, that is not free enterprise, that is John D. Rockefeller owning all of the kerosene in the United States and telling us the times are tough and we are going to have to see a shortened supply.

On the other side of the equation is the supply problem. And that is a problem in which you had two unusual participants. One was the energy industry which took advantage of an opportunity to, on this exchange, this futures market that we created basically in California, to get the highest possible price for their product.

But aiding and abetting them was the environmental lobby. And if you were sitting in a board room, I would say, in an energy company, and you were asking one of your analysts if anybody was going to come in and compete with you in California, thereby driving the price down, your analyst would say do not worry about it. If these other competitors who compete with us in other States try to build something in California, when the Sierra Club gets finished with them it will be 20 years before they build a power plant. So you had an unusual situation in which the supply was constricted. And it was constricted by some partners who on most occasions do not come together for any common cause.

And so what we have right now is, we are about 2 months out from summer. We know that our air conditioners are going to be turned on in the summertime. We know that industry is going to need lots of power. And we have to do something that government is not very good at doing, and that is building something fast. We can do it in California. We did it when we had the earthquake. We did not wait for massive studies and reports and the Endangered Species Act and all of the other regulations and laws to work themselves out over 2 and 3-year time periods before we acted to rebuild infrastructure that was damaged by the earthquake. We jumped right in.

And what we need to do today is to build supply. That means we have got to build power plants in California, and in the interim, we can move in some of these high tech power plants that we have, that we built in fact in San Diego County, that Solar builds, a Caterpillar subdivision. They built a great 13 megawatt generator that produces electricity very efficiently. And we sell it around the world. We sell it almost every place except in our own State, which it is very, very difficult to get this stuff sited.

So I would just ask you, Mr. Chairman, in closing, to look at a couple of things. One is a bill that I have that is directed toward summertime. And it says if you have a generator in the State of California, you can turn it on. Now, that seems to be elementary. But you cannot turn it on right now. You will have all types of agencies, environmental and otherwise, closing you down. So we have to have the right to turn on whatever we have got, whether it runs on diesel, natural gas, or whatever.

I have got another bill that says that the President and the Governor can waive siting requirements—that is, the bureaucracy that puts off siting of power plants for years and years—and move quickly to build power plants.

And the last one that I mentioned, the price problem, it gives the Secretary of Energy the right and the same power as FERC to reform unreasonable rates. And I think there is a difference between price caps or price fixing or price setting, and allowing energy to increase by 9,000 percent in 60 minutes. Thank you, Mr. Chairman.

Mr. BURTON. Thank you, Mr. Hunter, for that very comprehensive statement. And that first bill I think is—I have not seen the other two, but that first one seems reasonable to me, and I would like to be a co-sponsor of that one. And I will look at the other two.

We will now go to our first panel. Mr. Sam Hardage, who is the president of Woodfin Suite Hotels; Mr. Bill Horn, who is the chairman of the San Diego County Board of Supervisors; Mr. Douglas Barnhart, who is president of Douglas E. Barnhart, Inc.; Mr. Richard Thomas, the vice president of Alpine Stained Glass; Mr. Mark Seetin—I think he had to cancel.

Is Mr. Mark Seetin here? Oh, you are there. Thank you for being here. Mr. Mark Seetin. He is the vice president of governmental affairs for New York Mercantile Exchange. And Mr. P. Gregory Conlon, who is the former PUC president under Governor Wilson. Would you all please stand, please. Raise your right hands.

[Witnesses sworn.]

Mr. BURTON. You will each be recognized for 5 minutes. And because we have a long schedule, I hope you will stick as close to that as possible. And we will start with you, Mr. Hardage.

STATEMENTS OF SAM HARDAGE, PRESIDENT, WOODFIN SUITE HOTELS, LLC; BILL HORN, CHAIRMAN, SAN DIEGO COUNTY BOARD OF SUPERVISORS; DOUGLAS BARNHART, PRESIDENT, DOUGLAS E. BARNHART, INC.; RICHARD THOMAS, VICE PRESIDENT, ALPINE STAINED GLASS; MARK SEETIN, VICE PRESIDENT OF GOVERNMENTAL AFFAIRS, NEW YORK MERCANTILE EXCHANGE; AND P. GREGORY CONLON, FORMER PUC CHAIRMAN

Mr. HARDAGE. Thank you, Chairman Burton and members of the committee. My name is Sam Hardage, and I am chairman and CEO of Woodfin Suite Hotels, a national hotel company with 18 properties in 11 States. Here in California we operate properties in San Diego, Emeryville, Sunnyvale, Newark, Cypress, Brea, and Fullerton.

It is my pleasure to speak to you today concerning the impact the current electricity crisis is having on my company, and the travel and tourism industry in California. The committee is doing the people of California a great service by highlighting the impact of this crisis on various sectors of the State economy. Only through a thorough examination of how this crisis can and will affect jobs and income can the magnitude of this crisis be understood.

For all of my life, and I suspect the lives of most Americans, we have not even given a second thought to the simple event of turning on a light switch. We have always had adequate power to make our lives better. Indeed, the poorest of our citizens enjoy daily power and convenience that only kings and queens of a few centuries ago could command. In fact, cheap, abundant power has enabled Americans to participate in the most awesome growth of wealth in the history of the world.

Without reliable, abundant power, none of the industrial revolution would have been possible. Our citizens would be impoverished, and our lives infinitely worse. And yet, here in California, we seem to be trying to drive our citizens backward in time to an era of shortages and scarcity. Californians need to examine our priorities and decide what kind of future we really want as we begin the 21st century. The insane environment that we find ourselves in today will continue to reduce the availability of power, increase the level of misery for all Californians, decrease the number of jobs available for our citizens and our children, and make a mockery of the sacrifices that so many have made to build our mighty State.

I am optimistic that this dark view can be prevented, since the situation that we find ourselves in is entirely man-made. Our leaders in California need to stop blaming everyone else for the current situation, and take responsibility for their own actions. Providers of electricity, natural gas, and other sources of energy should be encouraged and welcomed into California with open arms, not driven away by shrill, mean voices threatening seizure, taxes, and more onerous regulation. I am hopeful that these hearings will provide the impetus for a return to sanity in California.

I am deeply concerned that the human cost in California will be enormous unless we correct the present situation. We are in the hotel business, which is one of the largest employers in the State of California. Our industry is gravely threatened by the specter of rolling blackouts and unreliable energy supplies. The effect on our State's business environment will be devastating, starting this summer. We have already seen many businesses sharply modify their travel plans, greatly reducing the number of room nights spent in California.

In March alone industry income dropped 3.9 percent in the San Francisco Bay area. Imagine yourself making a family decision about where to vacation this summer. Most tourists would rather not run the risk of being stuck in a hotel elevator, sitting in their hotel room in the dark, or otherwise having vacation plans interrupted by blackouts. Vacationers seeking warm weather without these risks may choose other vacation destinations, ranging from Florida to Hawaii.

California government officials have made clear that rolling blackouts will most likely occur in the early summer season. The fact that these threats persist can only have a chilling effect on families who are now planning their summer vacation. Fewer tourists means not only more empty hotel rooms, but also downward pressure on prices for those rooms we are able to sell.

The impact of this ongoing uncertainty will not be confined just to the tourism industry. Executives with major employers in California have indicated that they will curtail expansion in the State until the power crisis is over. With 82 percent of our company's business coming from the corporate traveler, fewer business expansions will have a direct impact on our company's occupancy rates and revenue streams.

Other States have been quick to exploit the uncertainty here in California, and have launched public campaigns to lure businesses out of State. One State recently sent flashlights to Silicon Valley executives as a reminder that their State may not have California's sun and palm trees, but their lights do stay on.

I am concerned that the sum of these consequences for our company could force us into a new round of cost-cutting sometime this year. With real estate costs, taxes, and other overhead costs fixed, skyrocketing utility bills would force us and other hoteliers to look to our labor force to bring cost into line, to prevent us from going into the red.

Those who own and operate hotels will not be the only ones to suffer as this crisis wears on. Unfortunately, the greatest loss will come to our treasured employees, who will be hit hardest by layoffs and job reductions due to the slowdown in the industry. Couple that with the increase in the personal misery felt as our employees also suffer at home with the specter of rolling blackouts. That is a recipe for a long, hot summer indeed.

The current situations has forced our hotels to impose a $4 per night surcharge on all of our guests. As an operator of All Suite Hotels, we attract a high number of extended stay guests. A typical corporate guest with a week-long stay now sees their bill rise by $28, purely for electrical costs. Over the past year our California hotels have experienced a 313 percent increase in our electric bills, and a 200 percent increase in our natural gas bills. The Loeas Coronado Bay Resort here in San Diego has experienced a 357 percent increase in its electricity cost, despite a 4-percent drop in consumption.

California has experienced extraordinary growth during the past few decades, precisely because it is such an attractive place to live, work, and play. While some parts of the country wrestle with the problem of out-migration, California has had no such problems. California is home to thousands of leading companies. The presence of these companies has helped drive California incomes up, and made the American dream possible for millions of Californians. But that future, which once appeared so bright, has been dimmed by threat of unreliable power supplies and skyrocketing cost. California and the people of California deserve better.

Mr. BURTON. Thank you very much, Mr. Hardage. Our next witness will be Mr. Horn. Mr. Horn, you are recognized for 5 minutes.

[The prepared statement of Mr. Hardage follows:]

Testimony of Samuel A. Hardage
Chairman and CEO, Woodfin Suite Hotels

Before the House of Representatives,
Committee on Government Reform and Oversight

April 12, 2001

Chairman Burton and members of the Committee, my name is Sam Hardage and I am the Chairman and CEO of Woodfin Suite Hotels, a national hotel company with 18 properties in 11 states. Here in California, we operate properties in San Diego, Emeryville, Sunnyvale, Newark, Cypress, Brea and Fullerton.

It is my pleasure to speak to you today concerning the impact the current electricity crisis is having on my company, and the travel and tourism industry in California. The Committee is doing the people of California a great service by highlighting the impact of this crisis on various sectors of the state economy. Most of the discussions to date have been lacking in specificity. Only through a thorough examination of how this crisis can and will effect jobs and income can the magnitude of this crisis be understood.

For all of my life, and I suspect the lives of most Americans, we have not even given a second thought to the simple event of turning on a light switch. We have always had adequate power to make our lives better. Indeed, the poorest of our citizens enjoy daily power and convenience that only Kings and Queens of a few centuries ago could command. In fact, cheap, abundant power has enabled Americans to participate in the most awesome growth of wealth in the history of the world.

Without reliable, abundant power, none of the industrial revolution would have been possible. Our citizens would be impoverished and our lives infinitely worse, and yet, we here in California seem to be trying to drive our citizens backwards in time to an era of shortages and scarcity.

Californians need to examine our priorities and decide what kind of future we really want as we begin the 21st century. The insane environment that we find ourselves in today will continue to reduce the availability of power, increase the level of misery for all Californians, decrease the number of jobs available for our citizens and our children, and make a mockery of the sacrifices that so many have made to build our mighty State.

I am optimistic that this dark view can be prevented since the situation we find ourselves in is entirely man-made. Our leaders in California need to stop blaming everyone else for the current situation and take responsibility for their own actions. Providers of electricity, natural gas and other sources of energy should be encouraged and welcomed into California with open arms, not driven away by shrill, mean voices threatening seizure, taxes and more onerous regulation. I am hopeful that these hearings will provide the impetus for a return to sanity in California.

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We have already seen many businesses sharply modify their travel plans, greatly reducing the number of room nights spent in California. In March alone, industry income dropped 3.9% in the San Francisco Bay Area.

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But that future, which once appeared so bright, has been dimmed by threat of unreliable power supplies, and skyrocketing costs. California, and the people of California, deserve better.

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Mr. BILL HORN. Thank you, sir. I normally only give people who testify 3 minutes, as Duncan Hunter can understand.

I want to thank you, Congressman Burton and members of the committee, and Congressmen, for being here. I am chairman of the San Diego County Board of Supervisors, and I am sure you are aware, as you are here, of the many stories that have gone on with the electric crisis in California and throughout the West. While I would like to reiterate many of these stories, I am sure you have heard them over and over again. I would like to focus on what we in San Diego have been experiencing.

The effects of this new market system that allowed for profiteering and market manipulation hit us hard last year. We were the first. During the summer of 2000 residents saw their bills jump over three times what they had been paying in the previous year. As the hot weather began, and the increase in demand, wholesale price for electricity climbed high, and generators profited tidily from this. The county of San Diego currently is $25 million over budget because of this electric crisis. Those are services that would have gone to our taxpayers, that have gone off to pay for the electric bills.

You may have heard of the numerous rallies, some of which I organized, and town meetings that were brought before SDG&E, and displaying the bills, and how the bills were hurting us. The rally that took place, that we organized and took place on San Diego Gas & Electric where residents burned their bills in protest, currently pointing out, as we go through this rolling blackouts which we just incurred a few weeks ago, that blackout occurred when southern California had plenty of power to keep the lights on. The problem is, the ISO ordered SDG&E to produce the blackouts so that we could suffer like the rest of the State did. And because of those blackouts, if SDG&E had not cooperated with those, they would have been financially penalized. And because of that, a number of our businesses experienced shutdown. We had employees who went home in the afternoon.

I am going to talk for a moment, and I brought you a tape, and this tape is for your committee. This is a biotechnology conference which I put on here in the county of San Diego.

Mr. BURTON. And we will have it there for the record.

Mr. BILL HORN. We have over 500 firms involved in medical research in San Diego. Of those firms, 250 are currently involved in FDA approved drugs. These rolling blackouts produced loss of experiments that had taken up to 3 years in two firms. Because they had no prior warning of the fact that the blackouts were coming and they could not put on secondary power, their labs went down. And when they went down, they lost 3 years worth of medical experiment on FDA approved drugs that were in the pipeline just because of the blackouts. They have to have warnings. I have met with SDG&E to see if we cannot, from now on, include those in the areas that get the prior warning.

We have learned that firms in San Diego and California cannot survive with the high energy costs in California, and will likely be looking to move out of the State unless we can come back with reliable supplies and a reliable market. One such company is Idec Pharmaceuticals, which outlined the risk of continued energy crisis on the health of their company. They anticipated higher manufacturing costs, in part due to the high energy costs. This firm, that is anticipating approval this year of a new cancer drug, now has to explain to its customers why the price tag of these drugs has risen, and could even become unaffordable. It does not take into account the fact that blackouts for any significant period of time could harm the ability to manufacture the clinical and commercial requirements of this product. These firms will look elsewhere to do business if we do not solve this problem.

Many businesses now include in the power crisis as part of their annual reports to alert their shareholders of the significant impacts that are damaging earnings. Shareholders will not stand by and watch their money go to generators. They will pull out, and you will see an economic downfall never before seen in California. As a businessman and someone who has always been an advocate of the free market, I now find that this crisis has put me in a position that I believe that we need to place temporary wholesale caps on electric prices, not only in California, but in the Western market. This must occur to restore stability and reliability for residents, industries, and customers in these States. I would suggest that at the Federal level, also, you consider extending temporary emergency emission credits to distributive generating facilities who come online during a Stage 3 alert. We have a number of those facilities in San Diego County that could come online. The reason they do not is they will be penalized if they use up their air credits. And so something we could do at the Federal level is, during this emergency, until we can get the supply back, extend to them those credits.

What we have not seen here in San Diego is a concern for the wellbeing coming from Sacramento. I just returned from Washington, DC, where I met with congressional leaders, Senators, and the White House, including Spencer Abraham, the Secretary of Energy. And I was surprised to learn that our Governor has been conspicuously absent from D.C. And I am concerned for the wellbeing of the residents and the economy of San Diego and all of California.

If we cannot find solutions quickly, we will surely lose our businesses, industry. And I know that San Diego cannot afford it, and I am sure the State cannot afford it. As chairman of the San Diego County Board of Supervisors, I urge you to examine all the possible solutions to this crisis at all levels. This is not just a California energy crisis anymore, but it extends throughout the United States. All eyes are watching to see what will happen here, and are fearful that if California cannot resolve this crisis, then deregulation will surely fail.

I want to thank you for coming to San Diego and for listening to our testimony, and God bless you for a speedy resolution of this crisis.

Mr. BURTON. Well, thank you, Mr. Horn. We appreciate your comments.

Mr. Barnhart.

Mr. BARNHART. Thank you for letting me be here today to participate in this field hearing on today's energy crisis in California.

The construction industry is feeling the effects of the energy shortage, like many other industries. I am Doug Barnhart, chief executive officer of the Douglas E. Barnhart Co., based here in San Diego. We are a construction management, general contracting firm, active in public and private construction in San Diego and elsewhere. In fact, if you came through Terminal 2 at the airport you might have seen our handiwork, or when your plane was flying into San Diego, you might have seen the sales enclosure at the convention center or the new ballpark.

I am a member of the Associated General Contractors of America. The 33,000 companies who are members of AGC are beginning to evaluate the impact of the energy crisis on the industry, and how the construction industry can play a role in alleviating the energy shortage.

The construction industry is a lagging economic indicator. While we have yet to see a dramatic drop in construction spending, we can definitely see the beginning of a construction slowdown based on the energy problems in the State. If the California energy crisis precipitates a national energy crisis, we will probably experience a national economic downturn that will impact all industries. That is why it is important that the crisis be dealt with rationally, methodically, and carefully.

AGC believes that the solution to our energy crisis comes from both energy conservation and energy production. Construction can ease production and transmission shortages through development of new facilities, and through the retrofitting of existing facilities. Furthermore, the promotion and production of energy efficient structures can promote energy conservation. California is the world's sixth largest economy. We have become synonymous with the technology boom. It is ironic that the same energy that powered our rise to become the world's technology leader is now threatening our tech-heavy economy. Once the haven of high tech, concern over rising energy prices and unstable power supply is opening doors to other States interested in stealing our employers. The State of Michigan has distributed glow-in-the-dark mouse pads; North Carolina has sent high tech companies batteries.

The following are examples of construction delays. Cisco Systems has placed two tech centers on hold, and is looking into alternative sites outside California's borders. A southern California refrigeration plant was recently canceled. In addition, the diversion of State budget surplus causes strong concern that funds set aside for infrastructure funding will be diverted to fund State electrical purchases. If this happens, schools, roads, bridges, and other essential infrastructure projects could be delayed or canceled.

The San Diego Economic Development Commission, of which the Barnhart Corp. is a member, conducted a survey of their membership; 33 companies responded, which collectively employed 24,667 workers. Here is what they said. Average monthly energy costs prior to June 2000, $57,000 a month; current monthly energy cost, $134,150 a month. Average bills have increased since June 2000 135 percent; 42 percent of those companies invested in capital equipment to promote conservation; 82 percent had made operational changes to conserve energy; 67 percent said administration/business operations would be negatively affected by blackouts; 33 percent, there would be significant amounts of lost inventory, wasted inventory by power outages.

The Barnhart Corp. mirrors the results of this survey. In the first quarter of 2000 our energy costs totaled $20,000; third quarter, they had exceeded $120,000 with the corporation absorbing the majority of the increase. I have even run into problems where owners now are refusing to take facilities, avoiding paying the energy costs during the summers and delaying taking them until the fall.

Tom Collier, an AGC contractor, closed his heavy equipment rental company because of high fuel and utility costs. This put 14 individuals out of work. Tom closed his business because he fears the construction market will be drastically affected by the energy crisis.

Hazard Construction, long a mainstay in San Diego, reports that during February 2001, employees were sent home in the middle of resurfacing projects, causing tens of thousands of dollars in losses due to blackouts.

Last month woman-owned AGC contractor I E Pacific experienced an unannounced rolling blackout at 1 p.m. They were in the process of posting accounts payable, lost all entries. The office staff of nine people were sent home for the day. Since the staff is salaried, they received no productive effort for wages paid, solely due to the blackout.

Construction contractors often must submit time-sensitive bids for projects. Every minute of the day is critical in developing the best value for the owners. We are very concerned what will happen if a blackout occurs on bid days. There would be no power, no faxes, E-mails, phones. This communication technology is essential in order to meet given deadlines. How is a general contractor to coordinate a bid with its subcontractors and provide responsible bids? What happens if a blackout does not affect all bidding contractors equally? These are just a few of the examples.

This problem is part a political problem. Government cannot control retail prices despite volatile swings in wholesale prices, as was the situation outside of San Diego. Any business owner will tell you this is an impossible situation. While it may be proper for government to step in and help pay for power in life and death situations, it should not be involved in keeping everyone from paying their fair share. A power subsidy has a detrimental impact because, by artificially holding down prices, it supresses the incentive to conserve power, and will only delay the construction of new facilities.

We worry about the impact of the energy crisis. We can fix this if we are permitted to use our God-given talents to provide new production and transmission facilities. We have a commitment to the community and the economy that is not shared by certain groups who have used well-intentioned laws as a means to impede much-needed construction projects. This is a critical issue for the industry, my country, my State, my hometown.

I hope that these hearings give you a better understanding of what has caused the problems, and that you can develop a strategy that ensures that the problems are not repeated in other States or nationally. I hope you can design a balanced response that can solve the problems here and elsewhere. I hope you understand that my company and the rest of the construction industry stands ready to do our part to alleviate this crisis. Thank you very much.

Mr. BURTON. Thank you, Mr. Barnhart.

Mr. Thomas.

[The prepared statement of Mr. Barnhart follows:]

Testimony of Douglas E. Barnhart
of
douglas e. barnhart, inc.
on behalf of

The Associated General Contractors of America, Inc.

Presented to the
U. S. House of Representatives
Committee on Government Reform

Field Hearing on
"California's Energy Crisis"

April 12, 2001
San Diego, California

SKILL RESPONSIBILITY INTEGRITY

The Associated General Contractors of America (AGC) is a national trade association of more than 33,000 firms, including 7,500 of America's leading general contracting firms. They are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects and site preparation/utilities installation for housing development.

The Associated General Contractors of America, Inc.
333 John Carlyle Street, Suite 200, Alexandria, VA 22314
Phone: 703/548-3118, Fax: 703/837-5407

Thank you Mr. Chairman and members of the committee for inviting me here today to participate in this field hearing on today's energy crisis in California. The construction industry is feeling the effects of the energy shortage like many other industries.

I am Doug Barnhart Chief Executive Officer of the douglas e. barnhart company based here in San Diego. We are a construction management and general contracting firm active in public and private construction in San Diego and elsewhere. In fact, if you came through Terminal 2 at the airport you might have seen our handiwork. Or when your plane was flying into San Diego you might have seen the Sails Enclosure at the Convention Center or the new Ballpark under construction.

I am a member of the Associated General Contractors of America. The 33,000 companies who are members of AGC are beginning to evaluate the impact of the energy crisis on the industry and how the construction industry can play a role in alleviating the energy shortage. The construction industry is a lagging economic indicator. While we have yet to see a dramatic drop in construction spending, we can definitely see the beginning of a construction slow down based on the energy problems in the state.

If the California energy crisis precipitates a national energy crisis we will probably experience a national economic downturn that will impact all industries. That is why it is important that the California crisis be dealt with rationally, methodically and carefully.

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The following are examples of construction delays:

1. CISCO Systems has placed two tech centers on hold and is looking into alternative sites outside California's borders.

2. Southern California Refrigerated Plant Project was cancelled.

In addition the diversion of the state budget surplus causes strong concern that funds set aside for infrastructure funding will be diverted to fund state electrical purchases. If this occurs, essential infrastructure projects such as schools, roads, and bridges could be delayed or cancelled.

The San Diego Economic Development Commission, of which the Barnhart Corporation is a member, conducted a survey of their members. 33 companies responded which collectively employs 24,667 workers. Here is what they said:

1. Average monthly energy costs prior to June 2000 were $57,000/month.
2. Current monthly energy costs are $134,150/month.
3. Average bills have increased since June 2000 by 135%.
4. 42% had invested in capital equipment that promoted conservation.
5. 82% had made operational changes to conserve energy.
6. 67% said that administration/business operations would be negatively impacted by energy "blackouts".
7. 33% said that there would be significant amounts of lost revenue/wasted inventory created by power outages.

The Barnhart Corporation mirrors the results of this survey. In the first quarter of 2000 energy costs totaled $20,000.00. In the third quarter, total energy costs exceeded $120,000.00. The Corporation absorbed the majority of the increase.

I have even run into problems myself where owners have refused to take control of new buildings to avoid paying the $35,000 per month in escalating energy bills.

Tom Collier closed his heavy equipment rental company because of high fuel and utility costs. This put 14 individuals out of work. Tom closed the business because he fears the construction market will be drastically affected by the energy crisis.

Hazard Construction reports during February 2001 employees were sent home in the middle of resurfacing projects causing tens of thousands of dollars in losses due to blackouts.

Last month AGC Contractor, I E Pacific, experienced an unannounced rolling blackout at approximately 1:00 p.m. They were in the process of posting accounts payable and lost all entries. The office staff of nine people were sent home for the day. Since some of the staff is salaried; I E Pacific received no productive effort for wages paid solely due to the blackout.

Construction contractors often must submit time sensitive bids for projects. Under normal circumstances, every minute on bid day is crucial in developing the best value for the owner. Contractors are very concerned what will happen if a blackout occurs on a bid day. If there is no power, there will be no faxes, e-mails or phones. This communication technology is essential in order to meet the given deadline. How is a general contractor to coordinate a bid with its subcontractors and provide responsible bids? What happens if a blackout does not affect all bidding contractors equally?

These few examples are representative of only a cross-section of the construction industry and business as a whole. These same effects are seen in every industry, every business, costing everyone time and money.

Our energy problem is in part a political problem. Government cannot control retail prices despite volatile swings in wholesale prices, as was the situation outside of San Diego. Any business owner will tell you this is an impossible situation. While it may be proper for Government to step in and help pay for power in life or death situations, it should not be involved in keeping everyone in the state from paying their fair share. A power subsidiary has a detrimental impact because by artificially holding down retail prices, it suppresses the incentive to conserve power.

As contractors we worry about the economic impact of the energy crisis. We believe we can play a role in alleviating the energy crisis if we are permitted to use our talents to provide new production and transmission facilities and construct energy efficient structures. We have a commitment to the community and to the economy that is not shared by certain groups who use well-intentioned laws as a means to impede much needed construction projects.

This is a critical issue for my industry, my country, my state and my hometown. I hope that these hearings give you a better understanding of what caused the problems in California so that you can develop a strategy to ensure that these problems are not repeated in other states or nationally. I hope that you can design a balanced response that can solve problems in California and prevent problems elsewhere. I hope you also understand that my company and the rest of my industry stands ready to do our part to alleviate this crisis.

Thank you. I would gladly answer any questions the committee may have.

Mr. THOMAS. My name is Richard Thomas, and I am the vice president of Alpine Stained Glass and Door located here in San Diego. I am the founder of Alpine Glass, and been in business over 25 years. Our company is quite diverse in the architectural and stained glass industries throughout San Diego and throughout much of the Nation.

We also distribute a lot of stained glass and related products to the hobby and craft industry, and that is basically through the Internet and worldwide sales quite often. Our main warehouse markets bulk glass and related products to glass studios, furniture and cabinet manufacturers, as well as craft stores throughout the Nation.

California's power crisis is affecting the wellbeing of my business in numerous ways, both directly, and even more importantly occasionally indirectly. I have highlighted six major obstacles that are currently facing us. No. 1 is our procurement of inventory. Our major glass manufacturer just outside of Seattle, WA, Spectrum Glass, was shut down on their power in December 2000 when the electricity they receive—they are an all-electric type of furnaces—was shut back and they were not able to produce a lot of the glass we needed. This created a situation of them not running the full line; consequently, their glass production was diminished, and it forced us to purchase glass manufactured in China. The glass was not of a quality we use in our upper-end doors and panels and entryways. This not only disrupted our schedule, the extra labor to accommodate this was absorbed by the company. Most of our jobs are contract.

The increases and fluctuations in power prices have created surcharges added to our freight bills. These surcharges are not normally a condition of freight contracts. This leads to erroneous cost projections for us, as well as inaccurate quotes to our customers. It degrades our reliability, and customer relations are slowly declining. Because of that, we have to keep adjusting for it. The method and amount of applying these charges varies widely from either the manufacturers or from the freight companies. What is good today may not be good tomorrow.

The power crisis has greatly increased our overhead costs for our utility and power bills. It has been up as high as 400 percent. All sheet glass and most of our material products have increased by a minimum of 10 percent since the first of this year, 2001. This is due to elevated manufacturing, not just normal inflation.

Alpine Glass has an extensive program of classes for training new students in the art of stained glass, as well as many seminars and multi-day workshops directed at professional artists and the advanced hobbyists. Professional glass artists and instructors are brought here from around the Nation to present these workshops. The increase in utility rates has prompted a decrease in students that are able to participate in these classes and directly purchase materials.

At this time—and this was as of about a week ago—we are showing almost a 40 percent decrease in attendance, which is actually leading to a deletion of these classes, or at best a postponement to a later date. In 25 years we have never had this problem, and I was shocked. Many of the attendees and many of our customers are on fixed incomes and cannot afford the high utility prices plus the hobby at the same time.

This tends to run into the area of or is especially true of any of the jobs that require the electric glass kilns. We sell them. They are a common item. You see them also in pottery areas. Twenty percent of our customers are retired, and use stained glass as a hobby, or even better yet, as a second income. Producing a stained glass panel or object that is not only beautiful, but quite practical, fills a very important need for their self-esteem. Our cost of running our electric kilns to slump and fuse glass has forced us to increase our prices on some of our finished products, as well as rental fees for student or customer use.

The increased cost of products beyond normal inflation, without any predictability, is forcing us to increase prices to our customers, or to absorb the cost from declining company profits. This scenario becomes quite apparent in some of our larger entryway and window projects that are often quoted many months ahead, as in the case of large institutions, hospitals, churches, or residences. They also have a budget to follow. And if our quotations become too far out of line, they will seek these services elsewhere in this Nation or out of country.

The situation and unpredictability defeats the reliability of our printed catalog. And they have always been on an annual basis. Furthermore, added to this increased product cost is the cost of labor, where our own employees are now having to sustain substantial increases in their basic cost of living expenses. The persistent and unpredictable timing of rolling blackouts has caused a great amount of anxiety and apprehension when we use our high temperature kilns, as I mentioned earlier, for classes or to produce products we have for sale.

Large investments of labor, not including product, can be ruined by just the power being turned off at any time. The cooling process in these kilns is at a controlled rate, meaning we cannot just cool it off in a very short period of time. It can run from 4 hours to 72 hours, or, as many of the professional glass artists, not only here but around the country have, they quite often can take anywhere from 5 to 7 day cycles. They will end up with 2 weeks of work in a project. If the cooling rate is interrupted at any phase of it, it is gone. It does not take long, with 2 weeks of work, to lose your faith real quick.

A little bit on climate control. Our ability to conduct business with our customers and clientele is directly linked to the availability of power. Light and temperature is extremely important to our company. Our customers and clients need to view colors with light. Does not work in the dark. When they come in, we have many, many wood doors, entryways, lampshades. We need light. Room temperature, when you have clients coming in, if they are not comfortable it is a sales fact. Uncomfortable customers do not buy. Never have.

Mr. BURTON. Mr. Thomas, could you summarize as quickly as possible?

Mr. THOMAS. Sure. I am right at the end right now.

Mr. BURTON. Thank you, sir.

Mr. THOMAS. Personnel reduction. We will have to eliminate jobs if it continues. There is not much other choice. We have done the same as all other companies in reducing it. We are using separate switches on lights, and as long as they do not compromise safety.

In conclusion, the power crisis has given us a jolt. But if we use our ingenuity and development of new operating procedures, we can endure this, unless the generating companies withhold their power and the ISOs continue rolling blackouts. We must take a much closer look at how we utilize our day-to-day electrical consumption. And I am a firm believer in this. A $10 energy-saving light bulb or a $3 switch is much less expensive than any interruption of power. I feel it is imperative for business to set the example and create a stabilizing effect. We should pride ourselves in how much we are able to save. It only makes good business sense. Thank you, Mr. Chairman.

Mr. BURTON. Thank you, Mr. Thomas.

Mr. Seetin.

[The prepared statement of Mr. Thomas follows:]

Mr. Chairmen;
My name is Richard Thomas

I am Vice President of Alpine Stained Glass and Door, located at 5801 Fairmont Ext. San Diego. I have received no federal government grants or contracts within the previous fiscal year.

I am the founder of Alpine Glass and have been in business over 25 years. Our company is quite diverse in the architectural and stained glass industries. Alpine's design and production facilities are know nationally for their architectural/stained glass entryways for residential and commercial applications. We also distribute stained glass and related products to the hobby and craft industry through our San Diego store as well as catalog and direct Internet sales worldwide. Our main warehouse markets bulk glass including related products to glass studios, furniture and cabinet manufactures as well as craft stores in the stained glass industry.

California's power crisis is effecting the well being of my business in numerous ways, both directly and indirectly. I have highlighted six major obstacles we currently face.

1.) It has effected our procurement of inventory. Spectrum Glass Company, our major supplier of sheet glass located near Seattle, Washington experienced a power shortage in December of 2000 when the hydroelectric power they receive from the Grand Cooley Dam was cut drastically. This created a situation of not allowing them to operate their full line of glass furnaces. Consequently, their glass production was diminished forcing us to purchase glass manufactured in China. This glass was not of the quality we normally use in our upper end doors, entryways, and windows. The need to purchase from out of country instead of from our established manufacturer not only disrupted our production schedule, but also the extra labor had to be absorbed by our company.

2. The increases and fluctuations in power prices have created surcharges added to our freight bills. These surcharges are normally not a condition of freight contracts. This leads to erroneous cost projections as well as inaccurate quotes to our customers, degrading our reliability and customer relations. This is especially true when we quote small furniture and panel shops that often place bids on large tracts of homes or developments. The method and amount of applying these charges varies widely from each manufacturer or freight company.

3. The power crisis has greatly increased our overhead cost by increasing our utility and power bill by as much as 400% over the same time period last year. It also has increased

our water charges due to the water district's increased power bills. These costs have been passed on to us. Also, all our sheet glass and most of our material products have increased by a minimum of 10% since the first of the year due to elevated manufacturing costs. The raw glass and tool costs are especially high.

4. Alpine Glass has an extensive program of classes for training new students in the art of stained glass as well as many seminars and multi-day workshops directed at professional artists and advanced hobbyists. Professional glass artists and instructors are brought here from around the nation to present these workshops. The increase in utility rates has prompted a decrease in students that are able to participate in classes and purchase materials. At this time we are showing approximately a 40% decrease in attendance which is leading to actual deletion of classes or at best a postponement to a later date. Many students are on fixed incomes and cannot afford the high utility prices and the increase in hobby costs. This is especially true if using electric glass kilns. Approximately 20% of our customers are retired and use stained glass as a hobby or second income. Producing a stained glass panel or object that is not only beautiful but also quite practical fills a very important need for their self esteem. Our cost of running our electric kilns to slump and fuse glass has forced us to increase our prices on some finished products as well as rental fees for student and customer use.

5. The increased cost of products beyond normal inflation without any predictability is forcing us to increase the prices to our customers or absorb the cost from declining company profits. This scenario becomes quite apparent in some of our larger entryway or window projects that are often quoted many months ahead as in the case of large institutions, hospitals, churches or residences. They also have a budget to follow and if our quotations are too far out of line they will seek these services elsewhere in the nation or out of country. This situation of unpredictability also defeats the reliability of our printed catalog that has normally been printed on an annual basis. Furthermore, added to this increased product cost is the cost of labor where our own employees have had substantial increases in their basic cost of living expenses.

6. The persistent and unpredictable timing of rolling blackouts has caused a great amount of anxiety and apprehension when using our high temperature kilns to produce product for sale or for class use. Large investments of labor and product can be ruined by power being turned off at any time the ISO's feel they need to. Due to the annealing process (controlled cooling) of glass this time can last from 4 hours to as long as 72 hours or more. There is no back up power available for these units. Our only option would be to attempt to schedule these processes during times of low power requirements thus necessitating employee rescheduling and overtime costs.

Many of the hot glass businesses and nationally recognized professional glass artists that are customers rely extensively on an uninterrupted power supply and are faced with losing up to two weeks of work and material costs from a rolling blackout. The effects on their business can be devastating. This has a direct effect on our customer base.

Climate Control and Lighting
Our ability to conduct business with our customers and clientele is directly linked to the availability of power. Light and temperature is extremely important in our company, as customers need to view the colors with light or match particular textures and colors of glass. The wood doors, entryways and lamp shades on our showroom floors require light to be seen clearly.

Room temperature is quite important to our clients as they quite often spend a considerable amount of time on our premises discussing their project with designers and technicians. There is a limit to the amount of discomfort they should have to endure. Sales fact: uncomfortable customers don't make purchases. Also when employees are too hot or cold they cannot perform their jobs correctly and efficiently resulting in a sharp decline in productivity and morale.

Personnel Reduction
If there is a continued lack of sales with a continued increase in product cost and power, then we will have no choice but to lay off employees. We must do what ever is possible to limit overhead and meet the financial obligations of our company. Regrettably, this employee reduction adds to an already unstable economy and an uncertain future for our industry as a whole.

Conservation
As a small business faced with this power "shortage" we are doing everything we can to decrease energy consumption while protecting employees' jobs as well as the future of our company. Alpine has instituted back up power supplies to its computer servers. This backup is quite limited and will only allow us to complete current transactions and then perform normal shutdowns. We have made arrangements for use of portable computers for short term backup usage. This system is not designed to support long term use. We are in the process of installing short term battery back ups to our phone systems. The showrooms, offices, and warehouse light usage is being closely monitored with separate switches being installed on fixtures not required full time.
Additionally, lights, computers and nonessential equipment are turned off whenever safely possible. We have restricted our use of the heating and air-conditioning systems as

much as is practical as well as having them maintained in top working order. Doors and windows are used for ventilation whenever possible. When feasible we schedule our high power consumption equipment such as large compressors, saws or kilns to run during off peak hours. Signs have been posted to remind employees of conservation. During the colder months we have used a pellet stove in one of our door showrooms instead of the forced air heating system.

Conclusion

The power crisis has given us a good jolt, but with some ingenuity and the development of new operating procedures we can endure, unless the generating companies withhold power and the ISO's continue to allow blackouts. Also, as a business we must take a much closer look at how we utilize our day to day electrical consumption. A $10.00 energy saving light bulb or a $3.00 switch is much less expensive than any interruption of power. I feel that it is imperative for business to set the example and create a stabilizing effect. We should pride ourselves in how much we are able to save. This only makes good business sense.

Mr. Chairman, this is the conclusion of my prepared statement and I thank you for your time.

Richard W. Thomas
VP Alpine Stained Glass

Mr. SEETIN. Thank you, Mr. Chairman and members of the committee. My name is Mark Seetin. I am vice president for government affairs for the New York Mercantile Exchange. NYMEX, based in New York City, is the world's largest physical commodities futures exchange, specializing in energy and metals. On any given day we trade three to five times world oil production, seven times North American natural gas production in a regulated marketplace. We are a regulated public marketplace.

Mr. OSE. Mr. Seetin, would you pull that mic closer to you. I can barely hear you up here.

Mr. SEETIN. I am sorry, sir.

We are a regulated public marketplace under the auspices of the Commodity Futures Trading Commission. As such, NYMEX does not have a stake in the outcome of this particular situation in California. Our interest has always been in competitive markets, and offering our services, which are not mandated, but voluntary. We provide competition under the auspices of the CFTC.

And I must say also that, just to make it clear to people, under Section 5 of the Commodity Exchange Act, fraud and manipulation are felony offenses. And we, as a marketplace, are bound by our oversight of those markets, to detect and prevent that. We also have no interest in whether commodity prices are high or low, only that they are fairly arrived at through competitive means, and reported.

California is in a real crisis. You have heard the symptoms, the results of this situation. I am going to talk a little bit about some of the causes and what can be done, hopefully, to help it. Our analysts agree that probably, among all the predictions on blackouts, that probably they are going to be on the high side. And we have heard some say as high as 55 days of rolling blackouts. From our market access and our looking at it, that is what we see.

But I want to say first of all that what California did was not deregulation. If you believe that California deregulated its industry, you will probably believe that Hannibal Lecter is a gifted surgeon. [Laughter.]

Does this sound like deregulation? You take three monopoly utilities, you create a taxpayer-funded, centralized monopoly power exchange through which the utilities are mandated to buy and sell all of their electricity and then you tack, inside of that, a cockamamie pricing system that, instead of matching buyers and sellers, like most of the rest of the world does—including Third World countries—you have one price clears all. So that no matter what the number of bids in this 1-hour block of lower prices, if it takes the highest price bid to fill that need, boom, you have got it. Our guys would go to jail if they did that. [Laughter.]

Well, maybe some should, I do not know, it is not my judgment. I am not done yet, though.

Because, you know, next you get the government that decides, OK, for this efficient marketplace the electricity bought and sold through this PX is going to be done in the next day, the day ahead. While the electricity market outside the PX had been evolving in a traditional energy path that we are familiar with of longer-term contracts, direct contracts, forwards, future swaps that move out into the future, this one mandated a 24-hour-ahead marketplace that was where the trading was going to take place.

Can you imagine GM being forced to buy their parts and equipment just a day ahead? I mean, that is as much sense as it made for electricity. Everybody knows what their needs are within a certain percentage. The electricity market was heading in the way of the traditional energy markets, that that spot market, that upclose market was a very small percentage.

The benefit of that, of course, is you have the price certainty of the longer-term pricing that direct contracts and forwards and futures give. But in addition to that, it is only a small percentage, so that if you do have a price spike, which happens periodically in commodity markets, it affects a much smaller part of the marketplace instead of the 30 or 40 percent that is in California. Well, I am not done yet.

Next, for good measure, the government, through the CPUC, steadfastly denied, because retail prices were still regulated, that the utilities could increase their rates, even despite the fact that these guys were paying 20 cents in the wholesale market and selling in at 5.5. I mean, they had the economic equivalent of the Ebola virus. They were hemorrhaging all over the place with cash.

They were then, in desperation, denied the ability to lock in prices through contracts last summer, inexplicably. Reports were in the press, apparently, that they had offers of 5 cent contracts, but they were not allowed to do that by the actions of the Commission. And it still gets a little bit better, because when the CPUC did take action last June—I think it was June 8th—they moved to allow the utilities to use other outside exchanges to procure their electricity.

Remarkably, within 5 days, on June 13th, when the State budget was adopted, there was a specific provision in the budget that created a study which prevented them from implementing that CPUC action. So, in essence, they were frozen out again.

Well, it did happen that finally the crisis got so bad that by August there was a ruling that allowed them to use a small, limited number of forward contracts. But guess where—out of the monopoly PX. Once again, if you call that deregulation, you know, it sounds to me like California put Dr. Jack Kevorkian in the recovery rooms. I mean, I do not know what they had in mind, but, you know, it certainly was not recovery from this standpoint. [Laughter.]

Every time a decision came up, it seems like—and I have been working here for a long time, so if I sound a little frustrated, I guess I have to confess I am—but every time the policymakers made a decision here regarding this marketplace, it always seemed like Yogi Berra said, "When you come to a fork in the road, take it." Well, in California when they came to a fork in the road, they stepped on it. Their foot looks like a pincushion at a quilting bee.

Where are we now? Well, only a couple of the players now have entered a new chapter. Of course, it is Chapter 11. That is the PX and PG&E. [Laughter.]

The utilities had their credit cards shredded last January, and now the State has stepped in, and the DWR is the sole buyer and seller of electricity in the marketplace. And that was 3 months and about $5 billion ago.

So where are we now? Still the critical problem has not been solved. And what is it? The State needs to immediately do a couple of things. First of all, they have got to implement direct access. This is the anathema that has been denied. You know, individuals outside are certainly not qualified to go and buy electricity, the businesses that are here, apparently, in the view of a lot of people. We think those people are the few that have the credit rating left in the State to be able to buy electricity.

Direct access means bilateral contracts. Let at least the 70 percent of the State that commercial and industrial businesses represent the chance to step out from under the State purchasing DWR and find and procure their own electricity. Under the law that was passed in January, that is illegal. In California, the only legal buyer and seller is the State. I mean, we trained the Russian oil company, Rosneft Product, at the request of the State Department in 1993. This was under the old Brezhnev regime. Rosneft Product had more freedom than these guys have. I mean, at least they traded in commodities.

You have to let the commercial and businesses out of there for two reasons: Because the State simply has not been able to take care of all the electricity purchasing on the long term that it needs, and it should not be expected to do that, either. The businesses need to do that. A benefit of that direct access movement will be to change the spot market that we are still in, because people are still having to buy, the energy is still being bought, largely in the spot market, and it is costing a lot of money. As I said, it is about $5 billion.

You know, people have been angry about the State government not talking about how much they are paying for electricity. But, you know what, you can figure it out fairly closely. As somebody said here, it takes about 30,000 megawatts a day to power the State. And you know that the utilities have about 12,000 of that or so. There is another 3000 megawatts that are the QFs. So if you put 10 cents or whatever the new price cap is on that 12,000, and you add about 14 cents, which is the agreement supposedly for the QFs, that leaves you about 15,000 megawatts to have to be purchased in the market by the DWR. So if every 10 days they are coming in and getting $500 million, that means $50 million a day, which is what the press reports say. If you take the 10 or 11 cents times the 12,000, the 14 cents times the 3, you wind up with about $33½ million that is being paid for the remaining 15,000 megawatts. A little math, a little division shows that that is about 22½ cents, roughly. Now, that is about probably what they are paying. Now, you know, I could be off by a few cents. But if you take a look at what the spot markets are—and you can look up on the Internet, a site called Interfacts, which prints out a lot of those sites—this is pretty well within it.

What the ominous part of that is, is that is still 22½ cents. And people are going crazy right now about their electricity rates being raised to 11 cents. The stunning part of this is, if I am even off by half, the rates have to come up a whale of a lot more to hit that market. So the bottom line is——

Mr. BURTON. Mr. Seetin, can you sum up?

Mr. SEETIN. What I am trying to say is, first of all, get direct access. Allow those commercial businesses to go out and take care of themselves. They can do that. That will help get the State off of this treadmill of the spot market.

Second of all, the other thing is transmission access. The ISO had a good proposal in January to allocate transmission capacity. That goes hand-in-hand with transmission access, so that buyers and sellers of electricity can lock in the transportation and the commodity price. There is nothing that will build this foundation faster, that is crumbling right now, than those two. Without building that foundation with direct access and transmission access, this building cannot be rebuilt.

Thank you, Mr. Chairman.

Mr. BURTON. Thank you. We did not get your opening statement, Mr. Seetin. Did we get that?

Mr. SEETIN. Yes.

Mr. BURTON. We do have that?

Mr. SEETIN. Yes.

Mr. BURTON. OK. I have not had a chance to look at that. Did that opening statement cover everything that you said?

Mr. SEETIN. Yes, sir.

Mr. BURTON. OK. I think that was a very important——

Mr. SEETIN. I did not have Kevorkian in there.

Mr. BURTON. I would like to know who writes your metaphors, though, because—they are in the opening statement? They are not?

Mr. SEETIN. No.

Mr. BURTON. Your metaphors were not in the opening statement, but I need a good comedy writer, so if you would give me your phone number, I will get a hold of you sometime in the future. [Laughter.]

Our next witness is Mr. Conlon, former head of the PUC.

[The prepared statement of Mr. Seetin follows:]

New York
Mercantile Exchange
NYMEX/COMEX. Two divisions, one marketplace

Statement of Mark W. Seetin, Vice President/ Government Affairs New York Mercantile Exchange

Before the House of Representatives Committee on Government Reform "Assessing the California Energy Crisis: How Did We Get To This Point, and Where Do We Go From Here?"

Thursday, April 12, 2001
10:00 a.m.

1331 Pennsylvania Ave. N.W., Suite 550
Washington, DC 20004
(202) 662-8770

The New York Mercantile Exchange is composed of two divisions. The NYMEX Division offers trading in crude oil, heating oil, unleaded gasoline, natural gas, electricity, propane, platinum, palladium. The COMEX Division offers trading in gold, silver, copper, aluminum, and the FTSE Eurotop 100® index.

Mr. Chairman, my name is Mark Seetin. I am Vice President for Government Affairs for the New York Mercantile Exchange ("NYMEX" or the "Exchange"). On behalf of the Exchange, I want to thank you and all the members of the committee for the opportunity to participate in today's forum concerning events in the California electricity marketplace.

The New York Mercantile Exchange "NYMEX," established in 1872, is the largest energy futures exchange in the world and the only futures market in the United States devoted exclusively to pricing, hedging, and trading industrial commodities. The merger in mid-1994 with Commodity Exchange, Inc ("COMEX,") that provides a forum for trading gold, silver and high grade copper futures contracts, created the world's largest physically-based commodity exchange.

The Exchange pioneered the development of energy futures and options. From a modest 34,000 heating oil contracts traded in 1978, NYMEX energy futures and options volume grew to more than 89 million contracts in the year 2000 and now includes crude oil, gasoline, natural gas, electricity and propane in addition to heating oil.

NYMEX provides the world's most efficient forum for energy price risk management. The visible and highly competitive daily trading of energy futures and options on the exchange provides a true world reference price for each of the commodities traded.

NYMEX has no stake in the direct outcome of the current crisis in the California electricity market. As a regulated, neutral public marketplace, it draws no direct benefit from either higher prices or lower prices. NYMEX only seeks the opportunity to compete in the provision of marketplace services, having never sought the role of government granted franchise to provide these services. In fact, NYMEX has expressly fought against the establishment of government created or sanctioned franchises to serve as marketplaces for electricity, believing those institutions should develop in response to market forces alone competing for the business of market participants in the same way that market participants should be competing with each other.

NYMEX has been an active participant in regulatory and legislative proceedings related to electricity deregulation and restructuring at both the state and federal levels since 1994. Directly related to California electricity "deregulation," the Exchange provided testimony four times before the California Public Utilities Commission ("CPUC"), two times before the appropriate California Legislature committees, and more than a half dozen times before the Federal Energy Regulatory Commission ("FERC"). The Exchange has provided formal written comments in these proceedings on about two dozen occasions. The theme of our testimony and comments has been consistently to support true market competition.

The debate that has taken place over the years regarding electricity deregulation or restructuring has been largely one between supporters of government intrusion to induce prescribed results and the supporters of unmolested competition. To date, there are no examples of a ***truly competitive*** free market for electricity in the US.

Critical Market Considerations Have Been Ignored

The area of consideration where NYMEX has provided most of its input has been on market structure. NYMEX has advocated allowing market structure to develop on its own without government interference. Unfortunately, we have not been very successful in this pursuit. California, in particular, rejected this position. In response to this, in proceedings before the CPUC and legislative bodies in 1995, NYMEX predicted the ultimate outcome of California's policies to be lower competition, higher prices, and lower consumer value. The past eight months these predictions have become manifest.

The chronicle of California's attempts to create a competitive market for electricity is one of mistakes and missed opportunity. California missed the opportunity in the mid 1990's to foster the creation of a truly competitive electricity marketplace. Our remarks today are intended to address the two most frequently asked questions; 1) What went wrong with California's efforts to deregulate the electricity market, and; 2) How can it be remedied?

What went wrong in California?

To call the product of the 1995-96 regulatory and legislative process "deregulation" flies in the face of all generally recognized and accepted definitions of the term. Indeed, as a result of the implementation of AB 1890, and California Public Utility Commission rulings and orders, the regulatory "overburden" of the electricity market in California arguably increased dramatically through the creation of the California Power Exchange through which the utilities were compelled to buy and sell their electricity, as well as the rules adopted within the PX regarding the "one price clears all" pricing method, and the calculation of the Competition Transition Charge (CTC) designed to compensate utilities for their "stranded costs." The net effect of the legislation and rules was to create a monopoly power exchange, and, worse, force the bulk of the California electricity market into a "day ahead" spot market, instead of allowing the market to choose its own venue of exchange, and terms of commerce. The CPUC went even further in attempts to "micromanage" in last year's actions to effectively forbid the use of commonly used financial instruments such as direct contracts, forward contracts, futures and options, with the sole exception being that of the use of the Power Exchange's "block forwards." **(See Attachments 1 –4)** The result of that disastrous combination of policies is evident today, as California faces the most serious threat to its electricity marketplace ever. At this time, under AB 1X passed in January, the state of California (through the Department of Water Resources [DWR]) is the sole legal buyer and seller of electricity. While the DWR supplanted the now defunct PX because the utilities had become "insolvent," the net effect is that the California electricity market remains a government monopoly.

How can it be remedied?

Direct access is key because it is the epitome of what is meant by market competition. The engine of competition in any market is the head-to-head competition for a customer that takes place between suppliers of the market's underlying product.

Rivalries develop in such head-to-head competition and these rivalries lead to experiments to better serve customers through innovations in product and service or the lowering in cost. The competitive process cannot take place unless the seller directly serves customers -- otherwise there is no market whatsoever and no sales. This is how competitive free markets operate for virtually every product and service.

This might seem obvious to the average person, but under "deregulation," electricity has operated according to a different paradigm that has relied to a varying extent on market artifices to serve in the middleman function. The artifices are state-created or mandated franchises to serve simultaneously in the role as buyer for any (sometimes all) sellers and seller for any (sometimes all) buyers. They have consistently been formed to serve the *spot* market (i.e. next day market, hourly market over the next 36 hours) and to clear offers to sell at one price.

It is no accident that where electricity markets have been structured to rely more heavily on this type of artifice, the development of *direct access* has been more inhibited and the level of real market competition has been muted. As a case in point, California was expressly designed to frustrate the development of *direct access*. The consequence of this action was eventual disintegration of competition, higher prices, and virtually no customization to better serve customers.

Ironically, *direct access* has ***not*** been the central consideration in either state or federal proceedings to date to "deregulate" electricity. In some venues, it has been accorded serious consideration, but even in these circumstances, the major focus has been on developing competition in generation. This has been conducted without regard precisely to how end-users would directly participate.

NYMEX is of the opinion that *direct access* is the most critical component of a truly competitive market. In fact, without *direct access*, there can be no truly competitive market. With respect to competition in generation, suppliers would have at least as great an incentive to reduce their generating costs in serving a *direct access* market as one where they are steered into selling to a government franchised artificial buyer. Furthermore, *direct access* is the only vehicle through which the customized needs of end-users would be served.

Under the alternative to *direct access*, transactions are concentrated in the state-franchised spot market pool, which is subject to greater overall price volatility and higher incidence of spiking prices. Tending towards the extreme, California adopted policies that drove the overwhelming majority of their transactions into the *spot* market. In contrast, a market centered on *direct access* transactions would never find itself at the mercy of the *spot* market to the extent California was. There would be far greater reliance on forward contracting.

Coupled with direct access is the critical component of access to the transmission system. Access to firm transmission is the essential "third leg" of a California recovery program. It is axiomatic that there be "user friendly" access to the transmission system to complete and perform the obligations of commercial transactions. For example, for all the goods and services delivered by truck there must be an accessible road and highway system for the deliveries to be completed. Analogous to this, in electricity it is absolutely essential for buyers and sellers to be able to acquire and transfer rights to firm transmission in the electricity grid so that they can be assured they can meet the delivery obligations associated with their commercial operations. As in other markets, it is contemplated that rules and procedures insure fair, competitive, and effective use of transmission capacity.

In fact, the California Independent System Operator ("ISO") presented such a system in January. The Independent System Operator ("ISO") staff presented a framework to deal with system congestion in a way that was supportive of direct access. Their proposal comes under the generic heading of a "physical rights" model that provides the greatest possible support for direct access. While the California grid is in great need of upgrading and enhancement, a congestion management plan such as the ISO staff developed for action last January was the correct remedy for congestion induced inefficiencies. This plan would harness market efficiency to enhance the overall performance of the transmission system. This is because, in addition to engineering criteria, it maximizes the market performance of the system based on market incentives as well. Tragically, this has been completely absent from California's market. The California State Senate and Assembly should urge the ISO to immediately submit a congestion management plan to the Federal Energy Regulatory Commission ("FERC"), so the tools necessary for California's "electricity recovery program" can be available as soon as possible.

California's major flaws were that it undercut the development of *direct access* and forced its market to rely artificially on the *spot* market. It did this through mandating participation in the *spot* market by utilities, applying the add-on *competition transition charge* ("CTC") to artificially render *direct access* transactions as uneconomic, and not providing an effective program for firm transmission. The result has been very limited participation in *direct access* in California. The remedy for this serious flaw is to immediately implement direct access with as few restrictions and as much flexibility as possible.

Conclusion

Perhaps the single most important thing that California failed to do in avoiding a supply and price crisis was to remove impediments in the electrical grid to true competition among buyers and sellers of electricity. Any California plan that addresses this issue should support ***direct access*** to the market for all buyers and sellers–the current system still greatly restricts access. California's plan relied on market artifices, frustrating the development of direct access and driving an overwhelming majority of transactions onto the "spot" market, where one is forced to trade only "day-ahead." The result of the monopoly Power Exchange's "spot" market was higher volatility and higher prices for electricity. Buyers and sellers of power could not be reasonably assured that they could make or take delivery of electricity in forward contracts. The California plan stressed developing competition among generators, but failed to provide for the most critical component -- ***direct access***. This and other critical factors, such as access to firm transmission on the power grid which support truly competitive markets, were omitted in the California plan. These omissions ***must*** be remedied for a real and sustained recovery from the current debacle to occur.

Mr. Chairman, once again thank you for the opportunity to testify. I will be glad to answer any questions.

Mr. CONLON. I think he just gave me a new name here. But I assume, Mr. Seetin, that other than the comments you meant—that you stated, that everything is fine.

I want to try to do two things today in my 5 minutes, is to give you the reasons for why we went through the restructuring and the deregulation of the generation. And I would like——

Mr. BURTON. Can you pull your microphone a little closer. Those mics are not picking up as well as——

Mr. CONLON. And how I think we got where we are today, you know, without attributing it to the restructuring and the deregulation.

I think you need to put in perspective where we started. Is this mic coming on now?

UNIDENTIFIED. We can barely hear you.

Mr. CONLON. Is this better? Is this better? OK? All right?

OK, I want to give you a perspective on why we started and why we did what we did. I think you have got to go back to 1993 and think a minute, for those of you who were involved in the business community at that time. This State was in a recession that was almost as bad as the depression. We had unemployment over 10 percent. We had lost over 500,000 jobs, almost 800,000 jobs in the State of California. We had very close to a depression going. I mean, compared to where we are today, you know, I think our recession back then was a lot more serious.

And without in any way demeaning what we are up against today—because we do have problems but I just think that with the situation we had at that time, we had large industrial customers and co-generators coming to us and said we are no longer building in California. There were two specific projects that I am aware of that were $250 million each that were built outside of California, and they attributed it solely to our high rates. We had the highest or the second highest rates in the United States, and in their view, we had the worst regulation in the United States.

So the five commissioners, at that time, were committed to do something to help the situation. Because all the high energy users in the State blamed us rather than the recession for their problem. So I think that is the environment we started in.

We went through hearings for 3 years. We had two different proposals on how to restructure the industry and how to fix the high rates and the poor regulation. So it was probably the most thoroughly examined hearings. We had over 50 to 100 days of hearings all day long, and I think that it was the most thoroughly examined proposals of what to do.

And I think you have to also remember at that time we had 30 percent excess capacity in the State. Our natural gas rates were the lowest in the United States because of deregulation 10 years earlier. So we were sitting with low gas rates and excess capacity. No one was going to build new power plants in California because of those two facts.

We even tried to order 3,000 to 4,000 megawatts of renewables back in 1995 and 1996, and everybody went hysterical. They went to FERC and got an order that said we could not build those plants because there was no need, and the prices were too high. They were 5½ and 6 cents. And I think here in San Diego it was 5½ cents, and you were paying 3½ cents. So the utilities in the State were against building any additions. Everyone was against it. So we threw up our hands and said hey, if nobody wants to build these plants, we are not going to build them. We have got 30 percent excess capacity, we have a 2-percent growth rate. That gives us 15 years of excess capacity. That is where we were when we went through this process, so that everybody understands that we were not doing this as an academic exercise.

So what did we do? We ordered—the major concern that we had was that if we tried to deregulate the market—which is what we concluded was the right answer, because it would happen faster and it would get more investment than if we tried to continue the traditional regulation. So we ordered the utilities to divest 10 percent of their—or 10,000 megawatts in a 45,000 megawatt market of their generation. And they agreed to do it.

So when they sold those plants, that created a situation where no player in the State had a large control of the market. And our main concern was market power. In spite of the market power you are concerned about today, if you only had two generators, the market power would be much more significant. We saw that in the UK, and we said that was not what we wanted to do.

So we created a situation where we had five or six competitors, rather than just two. We created the independent system operator, so that he could be the traffic cop, the airport director. And then we created the power exchange. And we created the power exchange only during the transitional period, about 4 years, to protect the small consumer. Because our view was if we start out with bilateral contracts, which is what Mr. Seetin is advocating, all the low-cost generation would be sold to the large customers, and the high-cost generation would be left to the small customers. So our belief was to have all the utility assets sold into the power exchange during the transition period, until they divested their assets and a market was established. And that is why we had the requirement that they sell into the market.

And we allowed all customers, large and small, for direct access. The legislators came along and put a rate freeze on, which virtually was very difficult for the marketers and suppliers to sell into the market, if they had a rate freeze and a power exchange. So the only people that really elected direct access were the large industrial users. They have today—about one-third of them have elected direct access, and about half of their volumes now are bought directly. And they wanted the opportunity to make their own mistakes. They did not want the Commission to set the rates, they wanted to go out and buy their own power. And some of them did. And some of them won, some of them lost. But that was the basic structure we did.

And I think what happened after that I believe is attributed to three acts of God and some delay in some government action. And we are facing the worst drought in 25 years in the Northwest. We are dependent on the Northwest for at least four nuclear plants worth of generation. We have been without that generation for over 15 months. And now they are—the drought this year is even worse than last year. So we are suffering where we are not going to get any hydro to speak of from the Pacific Northwest, and we have lost 2,000 megawatts in California.

So the 6,000 megawatts we have lost to reduced hydro is virtually the problem this summer. Because if we had those 6,000 megawatts, we would not have any blackouts. So let me make it clear that the hydro situation in the Pacific Northwest and California is one of the prime drivers for this crisis. And along with the fact that the price of natural gas is skyrocketing. It has gone up fivefold. I am not sure what these gentlemen were talking about when they said high prices, but the natural gas prices came through with at least a 200 percent increase in California, and all customers are paying it. So I think, when they say energy bills, they ought to be careful that they are looking at natural gas versus electricity. Because only in San Diego do the electric prices go up. Everywhere else in this State they have been frozen.

Mr. BURTON. Mr. Conlon, could you sum up?

Mr. CONLON. All right. And I just want to say that the energy commission has been blessed with 17,000 megawatts of new projects, and they have taken an average 18 months to approve those, as compared to other States, which do it in 3 months. And I think if the nine projects they have already approved, were approved 9 months earlier or 15 months earlier, we would also have additional supply. And they have got 15 more projects there that they need to approve.

We need to get these new projects out and approved, 17,000 megawatts in a 45,000 megawatt market would completely solve the problem. I mean, you are having one-third new capacity. They need to approve those plants as fast as possible. I do not know how you could help, but if you can, I will rest on that case.

Mr. BURTON. Thank you, Mr. Conlon.

We will now go to the 5-minute rounds for the Members. And I will start off here.

First of all, to the business people that testified, Mr. Barnhart and Mr. Hardage, have the high electricity prices threatened the viability of your companies?

Mr. HARDAGE. Mr. Chairman, the high energy prices will affect not only our company, but the electric company. [Laughter.]

The high energy prices will definitely affect not only my company, but every hotel company. Because of not only the direct effects of 300—so far we have had over 300 percent increase in our electric power cost. And other hoteliers have had the same problem.

The problem is that the indirect causes will have a greater effect, and that means that fewer businesses will be expanding or growing in California because of the uncertainty, fewer tourists will be coming to California. And when you combine a high fixed cost, and most hotels have debt and they have real estate taxes, they have operating costs, and you can only cut costs so much. So I would say that probably at the margin, that you would begin to see the less-competitive hotel companies and hotel sectors begin to suffer the most. And if this goes on for a long period of time without solving it, without solving the problem, without getting more supply—and the only solution is more supply, there is no other solution. So unless we get more supply, I would say that business, and certainly the hotel business in California, is in great danger.

Mr. BURTON. Mr. Barnhart.

Mr. BARNHART. Well, there is actually three answers. The first answer is the first price increases—because construction operates primarily on fixed price contracts, the first price increases, the companies took the hits right out of their bottom line, because they didn't have any choice.

The second round will be passed on to the owners. Because, as you are bidding new projects, you are going to price it right in on the cost for power.

The third round is similar to Sam's answer. What we figure, it is just a matter of time until somebody figures out, well, if we cannot supply all the power needs for the existing facilities, why do we need any new facilities. And then we are in a total—you know, we are in a total shutdown. And we will see owners delaying their projects, and we will see private owners moving outside the State. So, long-term, it is a disaster.

Mr. BURTON. Mr. Seetin, I got a great deal out of your statement, so pull that mic close because I do not want to miss what you have to say here. Can you once again go into the flaws that were—in the way that the California market was structured, and also why you think the crisis has lasted so long. And if you could, make it as quick as possible.

Mr. SEETIN. Sure.

Mr. BURTON. Not too long.

Mr. SEETIN. Again, I will try to be very brief. First of all, they created a mandatory power exchange. We said, you know, we do not mind if you take the taxpayer money, and it is not bad to create this exchange. It is unnecessary, because every other market, such as natural gas, those institutions competed with each other and came in without forcing the taxpayers to pay an additional piece.

However, if they would have not made that mandatory, others would have, and that would have stopped from happening what actually did happen, and that is that cockamamie pricing system where they take the highest price for every hour that fills the demand. Because somebody else would have said, hey, guys, there is a better way to do this. It is called matching buyers and sellers, which every traditional marketplace would have done.

When they then further stopped these people from using long-term and direct contracts, you have got that marketplace now forced into 24 hours. They cannot get those instruments. They could not get forwards if they wanted, because much of that market is short-term.

Which, by the way, when you want to talk about a link, natural gas is directly linked to that. About 60 percent of the electricity generated in the State comes from natural gas sources. When you force electricity into the day-ahead market, what have you done? You have done the same thing to natural gas. That is why it does not do any good to have a long-term contract with natural gas. You are going to make more of that the volatile spot marketplace.

Mr. BURTON. Well, let me followup on that. How do you think—and I think you covered this a little bit. But how do you think California could solve the current electricity prices. I see here from your notes that you are talking about direct access, which you just mentioned, and long-term contracts.

Mr. SEETIN. Right. The first thing you have got to fix—the thing that has been completely overlooked, everybody talks about the symptoms. Nobody looks at the cause. The root cause is a screwed-up marketplace underneath. You have got to fix that first. You have got to fix it with direct access. That will lead to other types of contracts—direct contracts, forward contracts, swaps, and future—that is going to bring financial soundness to that economy. It will bring in people to build power plants financed without the taxpayer's dollar, and it will stabilize the market. It is going to get away from that spot market because it is going to move everything into the future, where it naturally would go.

Second with that, you have got to have transmission access. You have got to have the ability for those buyers and sellers to lock in their space on that transmission line. And I am not talking about completely, because there is also the need to take care of the citizens, the hospitals, the schools, and that type of thing. I am talking just about for the commercial and industrial sector.

Mr. BURTON. So that is the recommendation you would make to the PUC?

Mr. SEETIN. Yeah, absolutely.

Mr. BURTON. Mr. Filner.

Mr. FILNER. Thank you, Mr. Chairman, and thank you, panel, for your testimony.

I do want to make several points for the record, and for the visiting committee and the chairman. Mr. Horn's appearance here as chairman of the Board of Supervisors to me makes the point, although you did not make it in your prepared testimony, Mr. Chairman, that the approach—that the legislation that we have taken in Congress, supported by myself, Mr. Hunter, Ms. Davis, is supported by the Board of Supervisors, supported by virtually every city council in our county. And I will tell this committee and this chairman that most of those are controlled by the Republican party, although all those offices are non-partisan, they are Republican registered. And so this is a bipartisan response to the crisis. It is a bipartisan response to say that we ought to set cost-based rates to get us over this disaster, and that we should refund the over charges.

I think that is a fair statement, Mr. Horn, is it not?

Mr. HORN. That is correct.

Mr. FILNER. Thank you, sir. This is a bipartisan approach, and nobody should think that it is only some Democrats screaming about this.

Second, we have heard many statements about it is environmental regulations and whacko environmentalists that have caused this problem. I think Mr. Conlon stated it very succinctly. The market that everybody here is praying to decided that there was no reason to build capacity over the last decade. That is, utilities themselves and the private sector decided that they ought not to build. As Mr. Conlon said, there was a forecast of 15 years of excess capacity. We have people, public-minded citizens in San Diego, who are going to build us capacity following all environmental regulations, and they will produce energy at a profit, and provide San Diegans with reasonably priced electricity. It is not environmental regulations. That is a myth that people are using to take advantage of this thing to get rid of all environmental laws that we have had in this Nation for some time.

I have heard from the business people at the table here very eloquently an expression of the situation you are in. It is disaster. And people who have less resources than your companies have gone out of business. Scores of our constituents are out of business, who could not cover this. But I did not hear any recommendations for what we ought to do, except you said that—I think Mr. Barnhart and others have said people ought to be paying fair retail rates. Well, Mr. Barnhart, you saw what happened when the retail rates were deregulated in San Diego. They tripled within 60 days.

You are all assuming there is a market at work here. There is no market. There is a control by a few companies. And what makes you all think that if we increase supply—which I agree with—that you are going to get a reduced cost? All of the assessments that have been made have shown that the wholesale price you are paying has no relationship to the time of day, to the demand, to the cost of anything. So what makes you think that the same few companies will not charge increased prices when the supply increases?

When we conserved here in San Diego and decreased the demand, prices went up. There was no relationship, because there is control of the market. And all of you folks who are complaining about the costs of your doing business, you are absolutely correct. But you are paying criminal rates. You are paying wholesale prices that have been found, by the Federal Energy Regulatory Commission, to be illegal. "It is the price, stupid," if I may coin a phrase.

It is not environmental regulations that are forcing you out of business, it is not that we are not paying adequate retail prices. It is not the lack of supply. There is no market. And you are paying a price that is demanded from you by a few people. Why do you not support the legislation that says have a refund for all the overcharges over the last 10 months? Mr. Horn and his board have supported that. And as I hear your recommendations or lack thereof, I hear nothing about renewable sources of energy, which I think is the key to the future in terms of our supply. I hear only let us build some more power plants, and the Governor is trying to do that.

What about public control of this situation? I did not hear anything about that. Where there is public ownership—as in L.A. or Sacramento, there seems to be some control of the pricing. They are not paying the prices that you are, that are forcing you guys out of business. So I sympathize with your position. And again, my constituents are paying a higher price than that.

But it seems to me your ideology is somehow refusing to let you face the reality that it is the prices that are controlled by a monopoly or by a cartel that are found to be criminal. We should demand the refund of those prices. And I tell you, Mr. Seetin, the structure that you have so eloquently described as flawed, which is—you are perfectly right—was set up by, you know, the previous administration, and had the goal as Mr. Conlon said, of increasing competition. It failed. But it was the cartel that took advantage of every one of those things that you pointed out to hurt the consumers of California. They took advantage of all that. They forced all the purchases into the spot market. They did not have to. They forced it in there. And all of the things that you described were caused——

Mr. OSE [presiding]. The gentleman's time has expired.

Mr. FILNER [continuing]. By a few companies who have ripped us off for $20 billion.

Mr. SEETIN. May I respond to that?

Mr. OSE. Unfortunately——

Mr. FILNER. That was a question at the end, so——

Mr. OSE [continuing]. Unfortunately, I am not sure which was a question and which was not. Perhaps on our second round we will have questions.

I am going to recognize Mr. Horn for 5 minutes.

Mr. HORN. Thank you, Mr. Chairman. This thing just seems to—well, we will just forget the little furry thing, whatever that is.

Mr. Conlon, were you in the Wilson administration?

Mr. CONLON. Yes.

Mr. HORN. What was your position?

Mr. CONLON. I was on the Commission for 6 years, 1993 to 1998. And I was president for 2 years, 1996 and 1997.

Mr. HORN. I think we all know that where the recession started was in March 1988, because of the end of the cold war.

Mr. CONLON. Yes.

Mr. HORN. And people were being let go, in certainly Los Angeles County, 400,000 people were out of work.

Mr. CONLON. Yes. Absolutely.

Mr. HORN. So I am interested in the role of Governor Wilson, because he was assaulted by the President of the current group in terms of it was all, it seemed to be, on his plate, not now, and do not bother us with it. So I would be curious what the Wilson administration did do in this period.

Mr. CONLON. Well, you know, they had an economy that was very sick, and the high energy users blamed the Commission and its regulation and the high rates, rather than the recession, itself. So I think the burden was on the CPUC to take initiative to try and lower the rates, and to try and open the market. And, you know, I think that the result of that was to do exactly what we did.

Now, I really think that the retail level for the small customers was deferred until the end of this year because of the rate freeze. I mean, I think the smaller customers really did not have the opportunity to lock in a rate. I mean, San Diego was offered a rate of 5½ cents or 6 cents last summer, and they had a debacle with the Commission, the current Commission, not to get that approved. But be that as it may, there was no energy suppliers that came into the San Diego area and offered individual customers 5½ or 6 cents, so they could have locked in the rate. Each of these gentlemen here could have locked in a 5½ or 6 rate if there was a marketer in the area willing to do that. And I pleaded with some of the marketers to come in. And they said hey, things are just too unstable now for us to even come in. Because, until the rate freeze was over, they were not going to do anything.

And I said, well, why are you not in San Diego?

And they said, well, we are going to stay in the wholesale market until the entire State comes off of freeze. So I think that was—the idea, though, was that competition would do a better job. I mean, we are in California. This is not the Republic of California. We got Silicon Valley, which is the heart of the free enterprise system. I mean, that is what has driven this State for the last 5 years out of the recession, into a prosperous economy.

So for us to turn to government regulation to make an allocation of resources was so inconsistent with the free enterprise system and the Silicon Valley prosperity. I mean, 7 percent of the growth was due to Silicon Valley and the computers and high tech.

So I think that Governor Wilson and the Commission were convinced that competition, in an area where you have multiple providers of generation, was the only answer. And that is why we went down that street. And I think if it had not been for the hydro problems and the run-up in natural gas because they had to use so much natural gas, and it was a cold winter this year, both in the Midwest and the East, that natural gas prices have driven these prices—if you look at the price composition, and I have got an article here out of the Fortnightly Magazine for February 15th, 75 to 80 percent of the prices throughout the summer were driven by natural gas and NO_x credits. And there was about 20 to 25 percent of those prices was due to other causes. And you can call it price gouging or whatever you want. But only 20 to 25 percent of the cost for those high prices was attributable to other than natural gas and No_x credits. And No_x credits were a large part of last summer's high prices. I hope I answered your question.

Mr. HORN. Mr. Seetin, you probably had a view of both the Public Utilities Commission 10 years ago, 15 years ago, and now. What advice would you give us in terms of how they conducted themselves?

Mr. SEETIN. Well, at this stage, I think we are in a situation where you have got to go forward. But as I said in my testimony, I think even when the crisis became apparent a year ago, things could have been done that would have mitigated it quite a bit, we believe. At any time they could have opened up the market to other exchanges, they could have allowed those people to use direct access, which would have had a very quick effect in that regard. It would not have brought on more supply, because that takes some time.

But the bottom line is, for example, they did not have a choice of whether or not to use the PX. That 24-hour-a-day, that day-ahead market was mandatory. They did not choose not to go in that thing. They certainly would have over the last year. It was put in by regulatory fiat and maintained by regulatory fiat. And, you know, that is where the responsibility—I am getting on dangerous ground here. But the policymakers that implement those institutions do bear responsibility, when things are going bad, to adjust that.

Mr. HORN. The current group there that is running the Public Utilities Commission just points all their fingers at Washington. Is that a realistic thing to be done, or is that just demagoguery?

Mr. SEETIN. When Washington, DC, gets the authority to rewrite California statutes that prohibit direct access and that oversee the power lines——

Mr. BURTON. [presiding]. Mr. Seetin, I am sorry, we are going to have to come back on a second round.

Mr. SEETIN. OK.

Mr. BURTON. Gentleman's time has expired.

I am going to recognize Ms. Davis for 5 minutes.

Mr. HORN. Thank you, Mr. Chairman.

Ms. DAVIS. Thank you, Mr. Chairman. And I appreciate all of you being here and sharing your stories with us. Obviously we met with many businesses that had dire predictions of the outcomes for them and for their customers, and I appreciate that.

I wonder if we could go to the issue of the long-term contracts. Because I am hearing different things, and I hope that you can clarify for me. You mentioned Mr. Seetin, and I know others have said that the real problem here was the lack of direct forward contracts. But it is also my understanding, and I wonder if Mr. Conlon could respond, that in fact the California PUC worked with companies to try and develop long-term contracts. And part of the requirement was that there be a reasonable clause as part of that. That is what most States have, or a lot of States have a reasonableness clause, so that you set it at one time, but that continue. Could you enlighten us a little bit about that, and did in fact companies not want to enter into long-term contracts that you tried to bring them into because of that?

Mr. CONLON. You know, this question really should be addressed to President Lynch, when she was here Wednesday. Because I am off the Commission and I am not—all I can speak is as an observer and as when I was a Commissioner. There is a great lack of faith and trust between the utilities and the Commission. And this debacle that you are talking about is manifested clearly, as you can see.

Because on one hand, the Commission says the utilities can go out and buy any kind of bilateral contracts they wish, but it is subject to review and refund after the fact. And the utilities say hey, if we go out and buy a contract and commit to $10 million and the Commission comes along 2 years later and disallows $2 million of it, I mean, how could we go out and contract in good faith with a creditor for $10 million?

So it is a lack of trust. The Commission does not trust the utility for reasonable prices; the utility does not trust the Commission, because in hindsight they could disallow the cost. So they need standards—and I think the Commission is working on that now—that are specific enough that the utilities can go out and buy contracts with the assurance that they were not going to get hammered after the fact. I mean, that is the problem. And your colleagues were here on Wednesday when they talked to President Lynch, so you can get from them what she said. I do not know exactly. I think she said they authorized the contracts, which they probably did. But the subject of refund and disallowance is the hook that the utilities have trouble accepting.

Ms. DAVIS. Did you——

Mr. OSE. If the gentlelady would yield, I would be happy to share with you after—when we break, the information that Ms. Lynch and the utilities provided us Tuesday and Wednesday.

Ms. DAVIS. OK. Thank you. But I really was wondering, did you know—was there a look at other States and the way that they pulled that together, so that they were able to agree to reasonableness?

Mr. CONLON. Well, the only other State that I think would be a good analogy would probably be Pennsylvania. And I think they relied on bilateral contracts almost entirely. Mr. Seetin, is that your understanding? Yeah. So I think they have a different situation. It was a spot market that Mr. Seetin was criticizing, that we felt was imperative to protect the small consumers from what we called cream skimming.

And, you know, this was only during the transition, which was 4 years. The PX today, the power exchange he was criticizing, went bankrupt 2 months ago. So it is no longer in the market. So there is no spot market today. And as a result, the new generators have no idea what the current price or the forward price of electricity is to build new power plants, which was one of the other reasons for having that. If you have a clear, deep, liquid price, then new investors can come into the State knowing what they are going to get paid when they invest their money.

Now, you know, we had a debate at the Commission with NYMEX on one side and two economists on the other, and this was a debate that went on for about 8 hours. So this was thoroughly hashed out. And everyone agreed to have this separate power exchange that bought into the whole process. And there was virtually no one dissented. So right or wrong, good or bad, there was complete consensus that the power exchange and the ISO were absolutely essential. And the power exchange is now gone. It is bankrupt. So NYMEX has 100 percent of the market, or anybody else. So if it is going to work, where is it?

Mr. SEETIN. Could I also add that the Harvard economists won that argument. That is why we are here today. We do not have 100 percent of any market. I want to make that clear. There is no mandate. So I just want to make it very clear, though, and we filed a lot of testimony, that the argument did go on like that, but we lost.

Ms. DAVIS. OK. Thank you. One more just followup question, if I could go back to you again, Mr. Conlon, for a second.

Mr. CONLON. Certainly. That is why I am here.

Ms. DAVIS. As we are talking about the competitive market and when the PUC had the ability to lift caps here in San Diego, when San Diego Gas & Electric indicated that they had no longer the market share that would have disallowed them from doing that, did you think at that time that there was a competitive market here in San Diego that would have responded in the way that we would hope the markets would have responded?

Mr. OSE. Before you answer, Mr. Conlon, you are going to have to hold your thought. The gentle lady's time has expired, and we recognize Mr. Hunter for 5 minutes.

Mr. HUNTER. Thank you, Mr. Chairman. Gentlemen, I think we have had a chance to understand a lot of the problem from your perspective, and probably watching the panel, you have been able to understand a lot of the problem from our perspective. And you have seen us agree, Republicans and Democrats, at least some of us, on the idea that 9,000 percent increases in a matter of minutes do not reflect a free market, they reflect a market that is certainly not an operation of free enterprise.

On the other hand, you have seen us also—at least myself—criticize the paralysis that we have in California, particularly, which—with the application of a lot of laws, including environmental laws. And you have seen a staunch defense of those laws by Mr. Filner. That is not slowing anything down. And he referenced Mr. Conlon to say, well, we did this because of our economic predictions. That is why no power plants came in.

But, Mr. Conlon, you also stated that plants that try to get permitted take about 18 months in California versus about 3 months in other States; is that not true?

Mr. CONLON. That is correct.

Mr. HUNTER. And are a number of those considerations not environmental considerations that lead to that 18-month delay in permitting?

Mr. CONLON. Well, the EIR and all the environmental constraints is what the Commission addresses. And they try and accomplish it in a year, but it usually takes 6 months to get the data adequate, if you will, before they implement their 1-year rule.

Mr. HUNTER. And Mr. Conlon, and let me—because we have got a limited amount of time.

Mr. CONLON. OK.

Mr. HUNTER. You are precisely right. And let me just give you a laundry list, in this effort that I am undertaking to try to get some generational capability at Miramar, our Marine Corps air station here. Walking down through this list the other day of what we have to comply with: the Endangered Species Act; the Clean Air Act; the NEPA process, which involves a number of public hearings, all duly noticed, and then our response to those hearings. The fact that we have attainment.

In California you can only put so much stuff in the air. And any Federal landlord—in this case the Marines—are worried that the amount of stuff that is put in the air, pollution that is put in the air by a generational capability that would supply the citizens of San Diego County will be charged against them under the law, to their air operations for the U.S. military, and could foreclose their air operations.

And so the bottom line was, after you walk through the environmental requirements in terms of meetings, studies, plans, permits, hearings, what are we looking at? And the answer: years. So certainly there is—one problem with this whole situation is it does not come neatly packaged. And certainly, for people that believe in free enterprise, who say no cost caps, they do not understand that there is, to some degree, the aspect of—electric supply has some of the aspects of public infrastructure. You have only a limited amount of lines that this stuff can pass through. You have a lot of difficulty in terms of siting locations. All those things that deny the one aspect of real free enterprise, which is easily qualifiable competition.

So, Mr. Conlon, when the economy did turn around and our usage started to go up dramatically, the problem was we could not easily qualify new plants that could come online and increase the supply; is that not true?

Mr. CONLON. Right. We had $10 billion of free private capital ready to be built in California without any government assurances, without any government incentives. This was all free enterprise investment. And they cannot get it through the energy commission on a timely basis.

So, I mean, that $10 billion, you could go back to regulation and let the State build the power plants and take the $10 billion away from the schools and the libraries and all these streets and everything else that California needs, also. So I think it is—you have got to define the role. And I think when you have got $10 billion of private moneys waiting to be built, let it be built.

Mr. HUNTER. Let us get down to business. One thing we could do right now that I think everybody is for, is if you have got a generator or if you can locate a generator—in fact, Solar tells us their power peaking plants that they built at the plant, you do not build them onsite, can be sited and started up within 1 week. Those are the easily transferrable units. Within 1 week. Meaning that if we had permitting taken care of in California, and in San Diego particularly, you could roll these components out on flatbed trucks, put them down on a cement slab and hook them up and have those babies going in a week, meaning we could save ourselves from summer.

So, Mr. Chairman, I have got H.R. 1075, which says if you have got a generator in California, you can turn it on without any punishment with respect to air attainment. And I would like to give that to Bill Horn, to our county supervisors, and to you. Thank you for your co-sponsorship. And Bill, if you guys could support us on this thing, I think this would give us a shot, at least, at saving ourselves from summer. Thank you very much.

Mr. BILL HORN. If I might, Congressman, I agree that if we could get some emergency air credits to these folks, we would not have any blackouts in San Diego. In fact, we did not get to get into that, but I do not think there is any reason for the blackouts in San Diego.

Mr. BURTON. Thank you, Mr. Hunter.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. Mr. Horn, the Governor has entered into a memorandum of understanding with one of the utilities to I believe acquire their transmission facilities. If the transmission facilities for San Diego Gas & Electric were acquired by the State, what is the amount of lost property tax revenue that the county would suffer?

Mr. BILL HORN. I am sorry, I do not have the number for you. The franchise fee, I believe, it is about $3 million, but I am not certain as to that exact number. I disagree with the Governor. I do not believe he should buy the transmission lines to free up capital for the utilities. I personally believe that there is enough capacity, at least in southern California, for us not to have any rolling blackouts. When we have plants, and the two plants both, Encino and Duke——

Mr. OSE. Mr. Horn, let me cut you off, because I noticed my time is evaporating here.

Mr. BILL HORN. Sure.

Mr. OSE. I just want to be clear. $3 million in lost——

Mr. BILL HORN. I am saying approximately. I do not know the exact——

Mr. OSE. OK. Approximately $3 million in lost franchise fee equates to what in terms of law enforcement, library service hours? Quantify that. I mean, you have quantified it. Tell me the impact.

Mr. BILL HORN. Well, obviously our budget in the county of San Diego is $3 billion. So I suppose we could absorb the $3 million. But at the same time, we now have a $25 million over cost overrun just in power alone. That is why you do not get all the lights in the chamber here. We are trying to conserve.

But at the same time, the $3 million does have a direct impact. I do not believe the Governor should be rescuing the utilities. They should have let them go bankrupt.

Mr. OSE. All right. Thank you. Thank you for your comment.

Mr. Seetin, I find your remarks on market structure—pardon the pun—highly illuminating. The concept that you have put forward about direct access strikes right at the heart of providing liquidity to the market, so that there is certainty on both ends of the transaction. If we had the proposal that you have made here for direct access—and I presume implicit in that proposal is the ability to contract—in addition to your proposal on the ability to acquire transmission capacity, how long would it take us to get out of this problem, this crisis that we have in California?

Mr. SEETIN. Well, it is hard to say. Depends on how quickly the law could be changed and enact this. We think it would be very fast, No. 1, because California is the world's sixth largest economy. There are, we think, a lot of people that would come in quickly to offer those instruments.

Mr. OSE. Let me back up. It is my understanding that the direct access prohibition is regulatory, not statutory.

Mr. SEETIN. No, it is statutory. The CPUC has not enacted the law that was passed, AB 1X, in January. They have not taken the action. But it is in the statute. The CPUC has not put the date in yet.

Mr. OSE. OK, 1890 did not prohibit access, but 1X does?

Mr. SEETIN. AB 1X does specifically.

Mr. OSE. Did 1890 prohibit long-term forward contracting by the utilities?

Mr. SEETIN. I do not think so. I am not sure, but I do not think so.

Mr. OSE. Does AB 1X?

Mr. SEETIN. Well, it is——

Mr. OSE. By its nature, it does?

Mr. SEETIN. Yeah. It is insignificant. Because it basically creates a single buying agency. That is the DWR. It does not matter.

Mr. OSE. In effect, it does prohibit long-term forward contracts?

Mr. SEETIN. Yes.

Mr. OSE. Now, if I look across the panel today, I see a market participant, Mr. Hardage; market participant, county of San Diego; a market participant, Mr. Barnhart; a market participant, Mr. Thomas. I see a market operator, Mr. Seetin. Is that accurate?

Mr. SEETIN. Yes, we operate the market. We do not have the physical commodities.

Mr. OSE. I understand. You do not take a pro or con position.

Mr. SEETIN. Right.

Mr. OSE. And Mr. Conlon, I see a market—with someone with experience as a market regulator.

Mr. Chairman, I have to say in Sacramento and in San Jose we did not have the opportunity to talk to a market operator. And I would commend his testimony to the committee and the rest of the Members of Congress, regardless of their State, as to the impact of I think your phrase was artificial standards and their impact.

I want to go back to one other thing we covered. I cannot remember if it was yesterday or Tuesday. The issue of a regional transmission organization. As I understand the market for power in the Western United States, the Rockies actually acts as the divider. In other words, West of the Rockies basically is a whole market, and East of the Rockies is a separate market.

Of those States West of the Rockies, some have put forward regional transmission organization plans and some have not. Which States have not? Is there some reason for them to hold out? And what is the consequence of having all the States participate or some of the States only?

Mr. SEETIN. I am glad this is not a quiz, because I would probably flunk that question. But I will tell you in general terms, those that are more resistant to the RTOs, the regional groups, are those that feel they have lower cost power and may be disadvantaged by being part of a larger group. I think that is fast going by the wayside, because they are seeing now that politically you cannot stop that border. Just markets cannot be held in. God knows, California learned that.

Mr. OSE. The testimony we had yesterday was that the 50 States, and I believe 49 have put forward their RTO plans. The one being absent is California. Do you have any information about that?

Mr. SEETIN. That would square with my basic knowledge.

Mr. OSE. That the markets are screwed up? All right. My time is about to expire. Mr. Chairman, I yield back.

Mr. BURTON. We are going to go to a second round. I do not think all the Members are going to take their full time. Some will. But I did want to ask one question I think is very important. Mr.—I cannot——

Mr. SEETIN. Seetin.

Mr. BURTON. Seetin. Excuse me. My Lasik surgery is not working right now.

Mr. SEETIN. Just think of looking at a tin roofing and see tin.

Mr. BURTON. There is a number of Congressmen and business people that believe that price caps are important, rate caps. I would like to have your perspective on that.

Mr. SEETIN. Well, we, you know, as a marketplace——

Mr. BURTON. And let me add one caveat to that. Eight of the Governors of the Western States have sent a letter to the Federal regulators saying that they are against price caps. The only three that did not sign it, I believe, were Oregon, Washington, and California. With that as a backdrop, will price caps work, or do you have to have everybody involved?

Mr. SEETIN. Well, obviously the more that are involved in that, of course, you spread the pain. Because, in fact, we do not believe that the history of those things has anything of success. They have failed every time.

Now, let me say personally I was a fan of price caps, because I grew up on a farm in Minnesota and we raised cattle. And when the administration, back in 1972, put a price cap on the price of beef, our cattle were selling for 58 cents. They put a price cap of 70 on and, boom, the market went right to 70, and we were happy for that price cap.

So I can just tell you that is traditionally how markets respond. In that particular market you are focusing on, it might deal with it, but then you have got all of the side markets that all of a sudden are influenced by that. So, as those off-peak markets may be influenced by that price cap, all of a sudden your net cost of energy goes way up and your supply is inhibited. Because, again, how can you say we want supply, but you can only get this much for it?

Mr. HUNTER. Mr. Chairman, would you yield on that briefly?

Mr. BURTON. I will be happy to yield to my colleague.

Mr. HUNTER. Thank you for yielding, because I think you have come to an important point here. The law right now has a species of price caps, in that the law says that FERC shall reform unjust and unreasonable rates, which seems to be an anti-gouging provision. But it is not necessarily a price cap or does not have a formula for figuring out how much you pay for electricity. But a 9,000 percent increase in a matter of minutes is not a matter of a long-term market adjusting itself, and it is not something that is going to, I think, motivate producers to get into the market. I think everybody is going to view it for what it is, which is a very short-term taking advantage of an opportunity that appears on the board.

So do you see any distinction between those two things? One, an anti-gouging statute, if you will; and No. 2, price controls?

Mr. SEETIN. First of all, let me make it clear that I do not believe that fraud or market manipulation ought to be allowed, and I agree with your contention that a price spike like that is an indication that something is very wrong, something is sick. That is very atypical for a truly competitive market, and you need to find out what that is.

We do not like price caps. But if price caps are the ransom in this, they are not going to do any good if you do not fix the underlying market. Again, I am getting back to that. If you do not fix the underlying market with direct access and transmission access, price caps will do no good. So if you pay the ransom of price caps, get the baby.

Mr. BURTON. Let me just reclaim my time and ask a followup question. And that is, according to the Federal regulators who testified in Sacramento, they indicated that there was only about 25 percent of the market that they could put a price cap on. Which means that you have another 75 percent of the market that would be not under the price cap. Now, if that is the case, and you had a supplier who was inhibited by the price cap, what would they do?

Mr. SEETIN. I think you have intuitively figured out one of the big problems in those things, and that is it.

Mr. BURTON. They would go to the 75 percent where they could make more money.

Mr. SEETIN. Well, just like if California decides to do it differentially, you know, you have 40 percent of your power coming in. What are those guys going to do if the power—if the cap is here and it is not——

Mr. BURTON. Well, I think that is the point I am trying to make, is if all the Western States in the grid are not together on this, or if all of California is not under the price cap along with them, then if there is a price increase, they are going to go where they can sell the electricity, and those that are under the price cap are going to suffer with blackouts. Now, did California not have price caps in December? I think they did. And I wanted to followup and just ask how did those price caps work, and why did they not work, if they did not?

Mr. CONLON. Well, the ISO had various degrees of price caps during last year. It went from I think $750 down to $500 down to $250. And then FERC came in in January and set a cap—a soft cap at $150 in January, and $420 in February. And they said yesterday to you that they were going to go back and do October through December, and then they were also going to do March and April, so that they will retroactively set a price based on the price of natural gas and the price of No_x credits for each month. And FERC I think is doing that, or did it for January and February. The ISO did it. When it went to $250, I think the price many hours went to $250, even though it was not the peak.

Mr. BURTON. Well, will price caps increase the likelihood of blackouts this summer, or reduce the likelihood?

Mr. CONLON. I do not think anybody knows for sure, but I just think that the main participants who are not under FERC's jurisdiction are the municipals. You are talking about LADWP, Sacramento, Palo Alto.

Mr. BURTON. Well, thank you, Mr. Conlon. You want to respond to that real quickly?

Mr. SEETIN. Well, if they do work, this would be the first time, I would think. The problem with those, you know, you are in a situation where you are worried about supply, and you are doing something that runs counter to that in the marketplace. That is the problem with price caps.

Mr. BURTON. Mr. Filner.

Mr. FILNER. Thank you, Mr. Chairman. You have opened an extremely important issue, and there is obviously different perspectives on that. And I think that is the debate that has to take place in a rational way without labeling.

But, I have a different perspective. I would point out that the panel does not have a cross-section of folks who we can ask that question to and get the kind of answers that at least might contribute to this debate.

You raised two important issues. One, if a price cap was not regionwide, obviously there would be differences in approach by different States. My legislation, and almost every legislation that calls for—not caps, Mr. Chairman, cost-base rates. And there is a real important distinction there that I want to add.

Cost-base rates are all regionwide applied in our legislation. So, and if I am not mistaken—although I would like this clarified later for the record—some of those Governors who you point to in the letter have in fact earlier come out in support of what the Western—far Western States supported. But California, Oregon, and Washington, all of whose Governors have called for cost-based rates, probably have a population and economy more than double or triple all the other ones combined. So if you had a weighted vote here, I think you would agree that the cost-base rates would win.

Now, on your issue about the jurisdiction of FERC, I will accept your number, 25 percent, for the sake of argument. But let us remember that 25 percent is what is determining the prices. It is that marginal control when supplies get tight that allows this cartel to set the prices.

And most of that other energy, as was pointed out by Mr. Conlon, and I think Mr. Seetin, is from municipals and Federal hydroelectric. These—by contract, by law, by practice—all have consumer-friendly rates. If you control the 25 percent that FERC has the ability to, you control the market here. That is why the prices are so high. The people who control that 25 percent control the prices. So if we brought them under control, you would have a reduction in prices and a stabilization in the market.

And I will tell the people who are ideologically opposed to this, you just keep yelling price controls, price controls never work. You know we have had cost-based rates for 100 years or since Edison. Utilities provided reasonably priced and reliable electricity. They made money. They were the most Blue Chip stocks you can buy if you were looking for that. And so I do not know who did not make money or what did not work there. But it is that cartel that is now setting the prices. If you eliminate all the structure—which I agree with Mr. Seetin, it was just a completely flawed structure—you are not going to have competition.

There is not a competitive market here. Those folks have destroyed basically any research and development of renewables. They have through the political process, gotten all kinds of incentives for themselves to make the money. I do not know why you think there is going to be competition.

You say let the markets work. There is no market. Mr. Hunter keeps pointing that out. And Mr. Hunter had an exchange with Mr. Hebert, who was then a commissioner and now the chairman of the FERC, who said in response to complaints that people on fixed incomes were making life and death decisions, that the markets must work, even if granny dies.

And even the Republicans on the committee had a reaction to that, including Mr. Hunter, who said look, Mr. Hebert, and I am going to quote, as well as I remember, Mr. Hunter. He said, "Look, Mr. Hebert, there is no more free enterprise person than me. There are no more free entrepreneurs than my constituents. But if you want to philosophize, Mr. Hebert, get on the philosophy unit. We have an emergency. We need a trauma unit at work." I think Mr. Hunter will remember those words.

Virtually all the public officials in San Diego County, Republican, Democrat, school board, city council, board of supervisors, Congress people, have looked death in the eye when we had full deregulation. And there was panic here in San Diego. The market was at work. And people went out of business, people suffered. We were the only ones, Mr. Chairman, who had full deregulation of retail prices. Everyone else in the State and the region had been shielded up until now. Now the prices are going to hit them. And I will tell all the elected officials in those areas, whether it is Washington, Oregon, Montana, New Mexico, and increasingly every Western State, as these obscene prices, criminal prices spread, and I think these guys are going to charge whatever they can until cost-based rates come—and they will eventually come, believe me—they are going to get everything they can. And there is no market at work that you are all praying to and praying for.

Mr. SEETIN. Could I respond just briefly. I just want to tell you that those markets do work everywhere but California, apparently. Because that is why we are around. People do not have to use us. And certainly, if we were not providing a service, I would not be here talking to you right now. So I just want to emphasize I strongly disagree with the fact that those markets do not work. They work everywhere else.

Mr. FILNER. Well, that is not accurate—we have not had the experience long enough for a, "deregulated market" for you to make that statement.

Mr. BILL HORN. If I might, Mr. Filner, you mentioned municipal utilities, and specifically L.A. Water & Power. I would point out that L.A. Water & Power sold excess energy which they got from Federal hydropower at less than 1 cent a kilowatt, into the market, and wiped out $85 million worth of bonds, at San Diego County ratepayers' expense, in 6 weeks. So I would like to——

Mr. FILNER. I have no trouble blaming with L.A. too. But take off the same, Mr. Horn, on Enron and Williams and Southern and——

Mr. BILL HORN. I will. I would be happy to.

Mr. FILNER. OK.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. I want to go back to Mr. Horn's comment here a minute ago. You are saying L.A. Water & Power had Federal power wheeled into its market area, under contract, and I think it is either Hoover or Glenn Canyon, that they are paying a penny a kilowatt——

Mr. Bill Horn. Less than a penny.

Mr. OSE. Less than a penny. All right, we are going to say a penny, for simplicity sake. A penny a kilowatt for the power. And then turned around and sold that power to the ISO.

Mr. BILL HORN. Back into the ISO.

Mr. OSE. This was the substance of the L.A. Times article yesterday.

Mr. BILL HORN. 23 cents a kilowatt hour they got for that power.

Mr. OSE. It seems to me, if I recall correctly, there are provisions in the Internal Revenue Code that you cannot use public bonding capacity and convert it to private purpose. And I am curious whether or not using L.A. municipal water and power facilities in this way is consistent with the law. And that may be above yours and my pay grade here. But I think that is a question we need to ask, Mr. Chairman.

Mr. BILL HORN. I think the other question I would like to point out is San Diego County, because it is a Federal dam. My ratepayers and my taxpayers paid for that power that they are getting. Now, they are fortunate——

Mr. OSE. That is exactly my point.

Mr. BILL HORN [continuing]. They are fortunate to have a municipal, and I would like to get one here in San Diego, but the law has precluded that until we get that changed. But at the same time, I think they should have sold that excess power into the grid or to San Diego at at least the cost of generating it and moving it to L.A., and then moving it to us. Not gouging us.

Mr. OSE. All right, I want to go back to Mr. Seetin.

Ms. DAVIS. Could you yield, Mr. Chairman, for just a followup on that, Mr. Ose, if you do not mind?

Mr. OSE. Sure. You yielded to me. I would be happy to yield.

Ms. DAVIS. Thank you. It is my understanding that they were compelled to sell into the ISO at the going rate, that they could not—is that correct? I mean, if someone could just——

Mr. BILL HORN. No. We mentioned price caps a minute ago, and I keep wanting to weigh in on these things. I am a free enterprise person and I really do not like the price caps. But we have got an unregulated monopoly at the moment. We took a regulated monopoly and made it unregulated.

I would get rid of the ISO, frankly. Allow these distributive utilities to purchase the power from the generators, and then we could at least get close to a free market. Because at the moment you have a controlled market. It is the last person in, they get the highest price, and everybody below that gets that same price. That is what has literally robbed San Diego County's ratepayers of their money.

We have a transfer of wealth going on here. And I think somebody mentioned the fact that we need a trauma unit. Duncan Hunter. We need a trauma unit here. We are being gouged from both ends, and we do not see any relief coming from Sacramento. Every time they make an adjustment—I would not bail these utilities out. Allow them at least to have a free market, and then we can hold them accountable. We cannot hold them accountable this way. We have an ISO who every 10 minutes can change the ball game. And I just think it is absolutely unconscionable.

Mr. OSE. I want to reclaim my time. All right, I want to go back to Mr. Seetin. In your statement you talk about the entire market, that being—you know, you have to have the ability to move power here and there to meet demand and supply. If one State is not participating in a regional transmission organization and all the States surrounding it are, in this example—and I cannot tell you if this is the case or not, so it is hypothetical. If California has not submitted its RTO plan and every other State has, what kind of difficulties does that create?

Mr. SEETIN. Well, it again creates two separate markets, theoretically. And that is what our experience has been. That every time you segment a market like that—and it really hurts the efficiency. Because, again, your products are not transferrable as easily. And from the marketplace standpoint, we have always urged that the control areas should be as broad as possible to maintain reliability and take care of the necessary things, of course.

Mr. OSE. I want to go back to one other thing. The PUC recently changed the manner in which the qualifying facilities are compensated for the power that they generate. In other words, they put a cap on the cost that they could factor into their retail rates, lowering the IER rating from 11,000 plus to 9,000, thereby making Biomass and other qualifying facility-generated power less remunerative.

The point I want to make here is that those are sources of power that are very favorable for us environmentally in terms of the air emissions that they put into the basis. In particular, in Sacramento and in San Joaquin Counties, we are a non-attainment area. And the consequence of a reduction in compensation to the qualifying facilities is that we will have to buy more power from other sources, which will contribute to our non-attainment. So, in fact, the PUC's order makes it more difficult for us to comply with air quality standards, and it is absolutely unnecessary, if we would just give the qualifying facilities the ability to directly access the market.

And I want to finally, Mr. Chairman—I think Mr. Filner is right. This is not a function of our environmental constraints, and I will tell you why. If you look at the major generators, whether they be the guys we like or the guys we do not like, they have facilities that largely are 10 or 15 years old. They have technology that is 10 or 15 years old. New technology converts gas to electricity at up to 50 percent greater efficiency than that old technology at 25 to 50 percent less in emissions. What we need to do is find a way to get that new technology online so we have reduced demand for gas, we can lower the price accordingly.

Thank you, Mr. Chairman.

Mr. BURTON. Ms. Davis.

Ms. DAVIS. Thank you. And thank you, Mr. Ose, because I appreciate your comments about the environmental considerations. I think there are a number of statements made by very responsible people, but that, in itself, is not the issue. But we do need to address that, and we do need to find those alternative sources of energy.

I wonder if we could go back just to Mr. Conlon for a second, because I know I was cutoff. There has been a lot of talk about competitive markets. And probably it is a little like so many other things, we cannot always describe it, but we know it when we see it. And I am wondering in San Diego, because part of the charge of the PUC was to lift the caps when the competitive markets were in place, could you share with us what indications you had or you believed that the Commission had that there were competitive markets that would work in San Diego.

Mr. CONLON. Well, I think the requirement was to lift the cap when the utility recovered all its stranded assets, not when the market was competitive. So, you know, the presumption was that the markets were going to continue to be competitive, because we had a 30 percent excess capacity. And I think a competitive market is where 20 or 30 percent of the players do not operate every day.

Otherwise, when you know you are not going to operate because there is 130 percent of the people in the market and there is only 100 percent, then prices are going to go down to meet the most inefficient player that is going to operate that day. So the guy that gets the 100 percent, his price sets the price. And the other 30 percent go home. They do not work at all. So that is when you get competitive markets, when these people go home instead of operating.

Ms. DAVIS. Would you say that today in the marketplace, then, that some of the companies that are operating have a market share that could be considered in the neighborhood of 15 to 20 percent?

Mr. CONLON. No. I am saying that we intentionally made sure that no one had more than 20 percent, because——

Ms. DAVIS. No, I understand that. I am sorry, if I could just interrupt for a second.

Mr. CONLON. OK. I am sorry.

Ms. DAVIS. I am wondering today—and we have the companies that are going to be joining us in a little while, whether you have the knowledge or impression, in some cases, that they actually do have the market share that we were working hard to insure that companies did not have?

Mr. CONLON. Well, the problem is, with the supply where it is, especially when you get into Stage 2 or Stage 3, that everybody has market power because you need every ounce of generation you can get. So that is why the market is not competitive, because there is not enough capacity available. If there was 110, 120, or 130 percent capacity available, then I think they would have no choice but to lower their rates. Because again, they would not be in the 100 percent that operates.

Ms. DAVIS. Thank you.

Mr. FILNER. I just want to point out, if the gentlelady would yield. I just want to thank the chairman. Ms. Davis and I, and Mr. Hunter, are not members of this committee, and it is by the courtesy of the chairman that we can join you today. And I just want to thank the chairman for giving us full expression of our questions, and allowing us to participate. I think it is very helpful to the whole debate. I thank the Chair.

Mr. BURTON. Well, I think Mr. Filner and Ms. Davis and everybody, all of us understand this is not a partisan issue. We have got to figure out, along with the Federal and the State regulators, some way to solve this problem.

Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman. I would like Mr. Conlon and Mr. Seetin to answer this. Agencies, over time, always have some sort of corporate culture, even if they are in government, not in the private sector. And I would be curious as to how you would analyze the relationships 15 years ago between the State utilities commission, that you headed, and the Federal situation, where right now everybody is pointing their fingers at each other. And I would be curious how you would think the Wilson, for want of a better thing—although other Governors had put their people in there—Wilson commissioners versus the Davis commissioners.

What is the difference between the two, and where is it that we are being shorted by our own Commission?

Mr. CONLON. Well, all I can say is what public statements that the present commissioners have made. And I think, by and large, they do not believe that there should be competition in the generation market, they do not believe that there should be deregulation of any form. I think at least two of the commissioners have been very vocal on that point.

And I think that all five of the commissioners under Governor Wilson were supportive of competition where there were adequate competitors. And with 30 percent excess capacity, I mean, we never dreamed of a supply problem. I mean, these events that have occurred, the drought, the worst in 25 years, we had the hottest summer in 100 years last year. It was the hottest summer in 100 years in the State of California.

And I think those two events, together, has caused this problem, not the fact that we had deregulation or a regulated. If we had a regulated market, if we had not changed anything, we would have had a serious problem in the entire State, and we would have had 30 percent rate increases under a regulated basis. Because the price of natural gas skyrocketed fivefold. And whether you are regulated or unregulated, if you are going to use natural gas, you are going to pay that price. It is an unregulated price done by the Federal Government 15 years ago.

So regulated markets today, we would have just as much rate increase as we are having today in an unregulated market. Because natural gas is driving it, and we have got the shortage of capacity. And, you know, until we get that 17,000 megawatts online, this is a serious problem. These short-term contracts the Governor did are just the right idea.

President Bush mentioned using aircraft carriers to drive—in the summer to drive power in the cities. And I think San Diego, with I assume two or three aircraft carriers, should certainly consider that in the short term. I read that in the press someplace. I am a compulsive reader.

Mr. HORN. Mr. Seetin, what would you like to comment on that question?

Mr. SEETIN. That is one you do not touch with a 10 foot pole. But I would just say this, that I think that clearly, if the market needs had been responded to, we would not be having this hearing here today. And I just think, from our standpoint and the market's standpoint, they continually missed the mark. That is all I can say.

Mr. HORN. I yield the rest of my time to Mr. Ose. Did he hear me?

Mr. BURTON. I think Mr. Ose has temporarily flown the coop. You are going to yield it to Mr. Hunter?

Mr. HORN. Mr. Hunter.

Mr. BURTON. Mr. Hunter, he yields his time.

Mr. HUNTER. Well, thank you, Mr. Chairman. I want to thank you again for having the hearing.

Gentlemen, we have got about 60 days until summer reaches us, and we are vastly understocked in terms of generational capability in San Diego and elsewhere. My colleagues—not to beat a dead horse, but my colleagues have said they do not think there is any environmental consideration here. That is kind of a myth and a red herring. So I wanted to offer to Ms. Davis, my good friend in the House, and Mr. Filner, co-sponsorship on my bill that says we will allow any business or individual in the State of California, or in any State experiencing a power emergency, which is defined as supply being within 10 percent of demand, to operate any type of power generator available to insure their economic stability. Now, gentlemen, do you all agree that would be a good thing for us to pass, now, on the Federal level?

Mr. HARDAGE. Absolutely. Absolutely.

Mr. HUNTER. Mr. Horn.

Mr. BILL HORN. I totally agree. We have enough capacity, if we could bring those generators up.

Mr. HUNTER. Mr. Barnhart.

Mr. BARNHART. Yes, sir.

Mr. HUNTER. Mr. Thomas.

Mr. THOMAS. I totally agree.

Mr. HUNTER. Mr. Seetin.

Mr. SEETIN. We are only the marketplace and neutral to that.

Mr. HUNTER. OK. Mr. Conlon.

Mr. CONLON. Well, you know, you have to define that very carefully, because the environmental concerns are still there. But you could certainly get it done in 90 days instead of 18 months. I mean, I think it is a matter of time.

Mr. HUNTER. OK. Let me then offer, Susan, could you get on my—since Mr. Filner asked me in the last hearing if I would cosponsor his legislation, which I did, could you sign up to this and say we are going to let anybody turn on a generator who has one in the State of California during an emergency?

Ms. DAVIS. Mr. Hunter, I appreciate your asking me that, and I will take it under advisement.

Mr. HUNTER. OK. Mr. Filner.

Mr. FILNER. Dr. Filner. I am glad we have 100 percent from the Republicans on this. But let me tell you, Duncan, I do not have any idea what your peaker plant proposed entails.

Mr. HUNTER. Well, then, why not sign it and turn them on?

Mr. FILNER. They are not the problem. This is not the problem. And we are going to have new problems if we go down your route. We have the ability to provide the energy that we need to our county and to our State that is prohibited—it is prohibited from being used now.

Mr. HUNTER. OK, Mr. Chairman, let me take my time back and follow on.

Mr. FILNER. It is not the environmental thing that——

Mr. HUNTER. If Mr. Filner's answer is not preceded with a "yes," I do not want to hear the rest of it.

Mr. BURTON. Let me interrupt just 1 second.

Mr. HUNTER. OK.

Mr. BURTON. Please. I feel like Johnny Carson on a bad night. Let me just say that Mr. Horn's time has now expired, and now it is your time for 5 minutes.

Mr. HUNTER. I thank the chairman. And now that we have established that, and my point is that we—this is a crisis and we do need to have a bipartisan response to this crisis. And I have told my friends who are the free marketeers that the 9,000 percent price spike is not free enterprise.

And I have also told my friends who have very strong environmental considerations, when you are going under for the third time and you want to reach for that lifesaver, and that lifesaver is the ability to turn on a diesel generator in your own plant to keep your life savings from going out in the next 2 weeks, you should be allowed to do it. Right now in California you cannot do it.

We have been told by Solar, which makes great generators, and Mr. Ose spoke about it, extremely efficient, makes them in San Diego with the great expertise of San Diegans, and we have been told by them that they can bring their peaker plants out and could actually set those babies up within a week, assuming that we could get into the production schedule, because everybody else and the rest of the world, except California, is buying them.

Mr. Barnhart, you are a contractor, a heavy-duty contractor who does lots of big infrastructure projects. How fast could you build 10,000 square feet of cement slab, if you were given a contract to do that? What kind of time are we talking about?

Mr. BARNHART. Just put down 10,000 square feet of concrete slab?

Mr. HUNTER. If you had to do it on an emergency basis?

Mr. BARNHART. We would probably have it down within 48 hours.

Mr. HUNTER. You could do it in 48 hours. Solar could move these peaker plants in and install them within a week. We are 60 days away from disaster. And in the State of California, in the county of San Diego, we are unable to help ourselves because of regulations and laws that we have to meet and comply with.

And so once again, Mr. Chairman, to our head of the board of supervisors, I would hope that the board of supervisors, which has met, incidently, with the Coalition for Electricity Independence, which is our group of business people in San Diego County who want to have the ability to save themselves by turning on a generator this summer, I would hope that the county of San Diego and the State of California—and I am still hopeful on this—would be willing to waive all regulations to let us save ourselves from this impending disaster. So, Mr. Chairman, I would hope that we could get co-sponsorship of 1075 or support of 1075 from the county board of supervisors.

And, Mr. Barnhart, one last question for you. You could build a 10,000 square foot slab in 48 hours. How long would it take you to knock out—assuming you were permitted—to knock out a 1-mile pipeline, a gas pipeline, 16 inch pipeline? You have done that before?

Mr. BARNHART. I have not done that specifically before. That might take longer, I would suspect.

Mr. HUNTER. Longer than 48 hours. OK. Well, we hope that you will work with us, and Sam and other folks who are interested in continuing to employ people in San Diego County, to get this—try to get some respite in before the summer reaches.

Mr. HARDAGE. Thank you, Congressman Hunter. We, in the hotel business, in order to keep the lights on, as a matter of fact met in executive committee yesterday to discuss the purchasing and installation of individual co-generating plants in all of our hotels here in California, because we do not know what we are going to do when the lights go out in California. And your bill would make it infinitely easier. Contrary to what Congressman Filner says, there are definitely very strong environmental hurdles to solving the problem. And your bill would literally help turn the lights back on. And thank you very much for introducing that.

Mr. BILL HORN. And I might say, on behalf of the board of supervisors, I would be happy to carry that and get your endorsement for you, Congressman Hunter. I would like to point out—my staff just brought me this—this is dated today, April 12th. Dynergy's plans for the 18 combustion turbines they have in San Diego County, they are refusing to turn on and to sell that power to SDG&E because they do not believe they are going to get paid from the ISO. And this is a transmission I just got from SDG&E. So there is 250 megawatts we will not have available if they refuse to sell them. And I am telling you, the ISO is the problem.

Mr. FILNER. And that is not an environmental restriction; right?

Mr. BILL HORN. They say they are not going to get paid, so they are going to refuse to give you the power.

Mr. FILNER. That is purely a price problem.

Mr. BURTON. Mr. Hunter, do you yield back your time?

Mr. HUNTER. Yes. In fact, I would be happy to yield the balance of my time to Mr. Ose, who stepped out at a—if he has any more questions to ask.

Mr. OSE. Well, I thank the gentleman from this area. And if I could reserve it, I would. And not wishing to spend the committee's time fruitlessly, I would yield it back to the chairman for further use.

Mr. BURTON. Well, I want to thank you for yielding back to me. We will dispense with this very fine panel we just had. Thank you very much for your testimony. You all were very eloquent. We really appreciate it.

We will take a 10-minute break, because I think you cannot think if you cannot—if your seat goes to sleep. So we will take a 10-minute break and we will come back with the second panel. Thank you.

[Recess.]

Mr. BURTON. The next panel consists of Mr. Kevin P. Madden. He is the general counsel for the Federal Energy Regulatory Commission. Mr. Madden has been with us before and has been helpful. Mr. Fred John, senior vice president for external affairs for Sempra Energy. Mr. Steve Malcolm, president of Williams Energy Services. And Mr. John Stout, senior VP for asset commercialization for Reliant Energy. Would you please stand, gentlemen.

[Witnesses sworn.]

Mr. BURTON. Let us start with Mr. Madden. Do you have an opening statement?

STATEMENTS OF KEVIN P. MADDEN, GENERAL COUNSEL, FEDERAL ENERGY REGULATORY COMMISSION; FRED JOHN, SENIOR VICE PRESIDENT FOR EXTERNAL AFFAIRS, SEMPRA ENERGY; STEVE MALCOLM, PRESIDENT, WILLIAMS ENERGY SERVICES; AND JOHN STOUT, SENIOR VICE PRESIDENT FOR ASSET COMMERCIALIZATION, RELIANT ENERGY

Mr. MADDEN. A very brief one. Mr. Chairman, thank you for the opportunity to appear here today to address the electricity matters and markets in California and surrounding States. I applaud this committee for the time and effort it has spent over the past 3 days gathering the unvarnished facts about the reasons why the electricity markets in California and throughout much of the West are in a state of stress.

It is my belief that these markets will continue to experience various serious problems throughout this coming summer. Wholesale prices have increased substantially. Consumers are being implored to conserve as much as possible. Generation has not been built for the past decade. Restrictions have been placed on long-term commitments. And utilities continue to face severe financial problems.

While some have accused FERC of being indifferent or even hostile to the concerns of California, I think our actions prove otherwise. I will not dwell on those actions, as I have already addressed them in my opening statement to the committee on Tuesday. I believe we need to work together, not point fingers at one another. We need this to solve the electricity crisis that exists now. We need supply, we need the market certainty, and we need to move forward. Thank you.

Mr. BURTON. Thank you, Mr. Madden.

We will now hear from Mr. Fred John, senior vice president for external affairs for Sempra Energy.

Mr. JOHN. Thank you, Mr. Chairman. Sempra Energy is the parent company of both SDG&E and Southern——

Mr. BURTON. Would you pull that mic a little bit closer, if you can.

Mr. JOHN. Sempra Energy is the parent company of both San Diego Gas & Electric Co. and Southern California Gas Co. My comments today will focus on both electric and natural gas issues as they relate to the State of California's present crisis.

You already heard from Mr. Seetin and former CPUC commissioner Greg Conlon on an overview of what has evolved in California over the past 6 to 7 years that got us to the point where we are today. And I would be happy to respond to some of those points that they made in the Q&A, but I am not going to reiterate all of those.

You have also heard from segments of the commercial and industrial market here in San Diego on the negative impact that high energy prices and poor power reliability have on them as customers, and also on the general economy in California. My comments are focused on what we think is the real crux of the problem, though, and that is skyrocketing wholesale electric prices. This was addressed earlier by Congressman Filner, Congresswoman Davis, and Congressman Hunter. But I want to amplify on these points.

One of the assumptions we made here in California, when the deregulation process started back in 1998, was that FERC would act as an effective policeman of the wholesale electric and natural gas market. Unfortunately, our hopes have been—we have been somewhat disappointed. I am not going to point fingers at FERC, and I know Mr. Madden made comments about it earlier. But we do believe that the Federal legislation is very clear. It is mandatory. It is not discretionary. Wholesale sellers of electricity and wholesale transporters of natural gas must be required to charge prices that are just and reasonable.

However, prices that are 500 percent higher tha historical norm clearly do not pass the just and reasonable test. Even FERC has agreed that the prices in the wholesale market do not pass that test. Yet for 10 months FERC has refused to require wholesale sellers of electricity to charge just and reasonable rates prospectively, or to refund dollars to consumers that exceed the just and reasonable standard.

We do recognize that in early March FERC did issue two orders with respect to potential refunds, and we are hopeful that they will follow through on that. But even the sums that are set forth in those orders are a small percentage of what the total alleged overcharges are, at least according to the California ISO.

We are also disappointed on the natural gas side, because we filed a petition in December 2000 with FERC requesting a temporary reimposition of the maximum rates on natural gas transportation in the secondary market. FERC has not yet acted on the petition, and transportation rates in California exceed those of every other State by ranges of $5 to $50 per million BTU.

I know there have been a lot of comments this morning about whether natural gas prices have driven up electric prices. I think you should also look at the flip side. Have the high electric prices caused natural gas transportation rates in California to have increased, and increased dramatically?

Our belief is that if FERC is not going to take further actions—and I still say there is an "if" there based on recent comments at least by Commissioner Breathitt—that Congress and the President need to step in. Commissioner Massey, himself, in testimony on March 20th before the House Energy and Air Quality Subcommittee said, "Power that cost California $7 billion in 1999 increased to more than $27 billion last year. Costs in 2000 may exceed $70 billion."

Customers—and believe me, we have been going through this here in San Diego since May. Customers are saying to us we are mad as hell, and we are not going to take it anymore. But it is not just an impact on the customers. Because of these wholesale price increases, and up to this point the refusal, until recently, of the California commission to pass through any of these costs, at least one of the major utilities in this State has gone bankrupt. And with all due respect to the statement that Supervisor Horn made earlier, I do not think it is responsible to say that a major utility, who is the backbone of the infrastructure in this State, should be allowed to go bankrupt. The State of California has also been required to purchase power on behalf of the investor-owned utilities, and they have already built up a bill of $4 billion, and that is on top of the $14 billion of under-collections that the utilities have absorbed.

Although the Commission in California has recently allowed retail rates to increase for PG&E and Edison, none of these dollars are targeted at their under-collections. The revenues are going to basically help the State repay its general fund.

Our view is, all of this could have been avoided back in the summer of 2000 if two things happened. One, if FERC had taken action on the wholesale side, and if the State of California had taken action on the retail side to increase rates, but to do it in a way where it was conservation-oriented, and higher use cause ratepayers to pay more money.

We respect the fact that Congress has held several hearings, including two field hearings: The one you have held, and previous hearings out in California. And we really respect that. But there does come a time for hearings to stop and action to be taken. And we think that time is now.

We also recognize that Congress is trying to do a lot of good things to help consumers, not only in California, but throughout the country. For example, a Federal tax cut bill. Well, what good is a Federal tax cut bill if the consumer has to use all of its payments to pay its electric and gas bill, and then it is still underwater? What good is a Federal education reform bill if parents do not have enough money to take care of the basic necessities of life for their children, or if schools are having to spend their money on electricity instead of on teachers and equipment? What good is a Federal healthcare reform bill if people have to make a choice between freezing in the winter or suffocating in the summer because they cannot afford to pay their gas and electric bills? It is time to act.

Mr. BURTON. Thank you, Mr. John. I think you made a very strong point there.

Mr. Steve Malcolm, the president of Williams Energy Services.

[The prepared statement of Mr. John follows:]

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM

TESTIMONY OF FREDERICK E. JOHN
SENIOR VICE PRESIDENT – EXTERNAL AFFAIRS
SEMPRA ENERGY

APRIL 12, 2001

Good morning, and welcome to San Diego. I am Frederick E. John, Senior Vice President-External Affairs for Sempra Energy. Sempra Energy is a Fortune 500 energy services holding company whose subsidiaries provide electricity and natural gas services. Sempra Energy's two California regulated subsidiaries are San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas). In addition to my testimony, I am also submitting for the hearing record SDG&E's request for rehearing of the Federal Energy Regulatory Commission (FERC) proxy price order. Thank you for the opportunity to testify at today's hearing.

California's energy crisis is the result of a terribly flawed market structure and the culmination of serious supply and demand imbalances. Electricity has a highly complex commodity market delivery structure, one that cannot be changed in a piecemeal fashion. In retrospect, it is clear that the state did not create a truly competitive electricity marketplace. Rather, it is now clear that the product created by AB 1890 (the state legislation that restructured California's electricity market) and the California Public Utilities Commission's (CPUC) orders implementing AB 1890 were flawed. The legislation created a hybrid electric industry that was neither regulated nor deregulated, and that has produced price run-ups at the wholesale level that are almost beyond comprehension and are certainly not explained by "tight" supply or input costs alone.

Today, nearly all Californians and much of the population in the West are bearing the burden of this experiment gone awry with incredibly high prices and rolling blackouts. Recently, the Governor of Washington state testified before the U.S. Senate Energy

Committee that, even though his state never deregulated its electric system, the Pacific Northwest is losing $1.4 billion a month due to high wholesale electric prices. Meanwhile in California, the crumbling credit of the utilities forced the state to step in as the buyer of power, and now it appears that the state's $6 billion surplus may be drained away to a deficit by this Fall due to the excessive price of electricity. Also, on Friday April 6, Pacific Gas & Electric Company (PG&E), the largest electric utility in the U.S., declared voluntary bankruptcy under Chapter 11 of the U.S. Bankruptcy Code.

These circumstances warrant action by the federal government, but unfortunately little action has been forthcoming. While much of the problem can and must be solved by state government, some aspects of the crisis can only be solved by the federal government. Let me urge all of you here today to take immediate action before a national economic crisis occurs. Too much is at stake for federal regulators and legislators to sit on the sidelines. As Federal Reserve Chairman Alan Greenspan told the U.S. Senate Banking Committee in January, "It is scarcely credible that a problem can exist in California which does not feed the rest of the 49 states. The energy crisis in California threatens the economic wellbeing of the nation."

Unfortunately, our federal regulators have been largely ineffective throughout this crisis. Everyone agrees that we face very tight supplies of electricity this summer. Everyone also agrees that the current market has demonstrated that even the slightest tightness of supply will lead to skyrocketing prices and rolling power outages. Even the federal regulators agree that these prices are not "just and reasonable." Yet, they have failed to act to enforce the law and protect consumers in the western states by reining in the high prices. The state of California is working hard to bring on additional supplies and to lower demand for the summer so we can mitigate blackouts. But only the federal regulators have the authority to act to protect consumers from the continuing economic disaster of these unjustified and massively excessive electric commodity prices.

Market Design Flaws:

There are many examples of how the "deregulated" electric system created by AB 1890 accelerated supply and demand imbalances to create the crisis we face today. AB 1890 required utilities to sell their electric generating plants and buy the electric commodity through the California Power Exchange (PX). It is now apparent that by requiring that the investor-owned utilities purchase electricity through the PX, AB 1890 created a loophole that allowed the new owners of the generating assets to charge unreasonably high prices for the electric commodity and, at times, withhold selling the commodity into the PX until the last minute. Because AB 1890 required the utilities to purchase the power at the highest price bid into the PX, there was no incentive to bid early or bid low. The market created was one in which wholesale electric commodity prices bore no relationship to the cost of production, demand or time of use.

When the PX began to offer forward contracts in July 1999, state regulators would not allow the utilities to contract forward for more than ten percent of their load. SDG&E had requested authority to participate in the PX Block Forward Market (BFM) without limitation. In granting utilities limited authority to participate in the PX BFM, the CPUC warned utilities not to speculate in using their newly granted authority. While in March 2000 the CPUC did extend the authority of PG&E and Edison to participate in the PX BFM, it noted that the extent of the authority (as well as issues related to the recovery of costs attributable to block forward market participation), would have to be reconsidered when these utilities came out from under the AB 1890 rate freeze. At that time, SDG&E had been out from under the rate freeze for nearly a year.

The CPUC also prohibited the utilities from executing forward (or bilateral) contracts directly with power generators (or otherwise using opportunities that existed outside the PX or ISO), but limited them to the PX block forward as well as the PX and ISO spot markets. Simply put, the utilities' hands were tied as the state stood on the precipice of an energy crisis.

It was not until the summer of 2000, with extremely high temperatures and skyrocketing electric commodity costs, that the CPUC allowed utilities to secure bilateral contracts outside the confines of the PX. However, the CPUC did not establish any standards or criteria about how the utilities' purchases would be determined to be reasonable. The absence of reasonableness standards subjected the utilities to significant risk of future "disallowances" by the CPUC.

While California was struggling to implement its newly deregulated electric system, problems with supply and demand imbalances in the western region surfaced. These problems were exacerbated by regionally hot weather, low hydro conditions in the Pacific Northwest, changes in generator bidding behavior, and other unforeseeable factors that are still not completely understood. Demand for electricity exceeded the available supplies in the state, and California required additional power from outside of California.

Although California's demand growth over the 1999—2000 period (the time period in which price spikes began) was relatively flat, demand growth in the other states within the interconnected grid of the western region was strong. In fact, it has been estimated that nearly 85 percent of the growth in electricity demand over the past five years in the western region has occurred outside of California.

While no new major power plants have been built in California over the past 10 years, that situation is generally true throughout the western region. Part of the problem in California is due to the state's historically difficult licensing procedures and rules that are expensive and time consuming to navigate. But while people have testified to Congress that California's problem is that there has still not been one shovel of dirt turned on a new power plant in our state, in fact steps are already underway to immediately increase generation. Since April 1999, six powerplants (which represent 4,700 MW of new generation) have been approved. Five of the plants are under construction and a sixth is scheduled to begin construction this month. Twenty more power plant applications are being reviewed by the state Energy Commission. These developments and the recent creation of the Governor's Green Team (charged with accelerating the siting and permitting of generation and coordinating local, state and federal government agency review and action) represent important steps to increasing much needed supply within the state.

Even with the new plants approved, the power they will generate will be slow in coming. The first new plant is not expected to be on line until mid-2001, and it will not provide nearly enough power to mitigate the current shortage. After years of inaction and delay, there will be a time lag between recent approvals and the provision of needed electric supplies. While we applaud recent efforts to accelerate approval and licensing of greenfield plants and the repowering of existing plants, the long-standing supply imbalance can't be fixed overnight. Furthermore, the supply that is currently available has been frequently off-line (through scheduled or unscheduled outages), triggering shortages at even very low levels of demand. Recently, Energy Secretary Spencer Abraham met with generators to discuss the problem of the outages at the merchant generation facilities and the deleterious impact this has had on consumers. We certainly hope action can be taken to address this very real concern before the hot summer weather begins.

In the meantime, until sufficient power is available, the state must significantly reduce consumption to conserve available energy. However, the imposition of retail rate caps prevents any market signal to reduce consumption because of no correlation between the wholesale price of energy and the retail cost paid by consumers.

Impacts on SDG&E and Its Customers:

In July 1999, SDG&E became the first utility in the state to pay off the debt on its stranded assets (as required by AB 1890 to enter the competitive market). Once SDG&E opened its market to competition, the utility passed through to its ratepayers the market cost of the electric commodity. While everyone knew that summer prices could be higher than other times of the year, these summer price increases went far beyond what anyone had anticipated. Forecasters, as well as forward markets, predicted prices similar to the summer of 1999, not 500 times higher. Equally unanticipated was the fact that we did not actually experience price spikes. Rather, the prices rose and stayed high 24 hours a day, 30 days each month! It was unclear how all of the problems that contributed to higher electric commodity prices fit together, and what could be done by the state or federal government to remedy the problem.

What did become abundantly clear was that the extraordinarily high prices being paid by San Diego consumers created a politically untenable situation. In an effort to "fix" the problem for SDG&E, AB 265 was passed and capped at 6.5 cents per kwh the amount that residential and small commercial customers would be charged for the electric commodity. Yet, SDG&E continued to pay upwards of 22 cents per kwh to its suppliers. SDG&E was required to place the difference, or undercollection, in a balancing account to be repaid in 2002 or 2003. However, the bill did not specify the mechanics of how the undercollection would be repaid. In short, the state Legislature's cure became worse than the disease.

The most serious and immediate problem that SDG&E has faced is the growing balancing account, which now exceeds $700 million. Last week California's governor signed into law SB 43X, a bill that establishes a rate cap of 6.5 cents per kwh for SDG&E's large customers currently not covered by the AB 265 rates, retroactive to February 7, 2001. Unless the California Department of Water Resources (DWR) continues to buy power to cover SDG&E's "net short" requirements, and SDG&E's revenues are sufficient to cover the costs of retained generation, the balancing account will grow. While AB 265 guaranteed the utility recovery of its prudently incurred costs, the enormity of the account has far exceeded original estimates and it has become a growing balloon payment that must be paid in the future by SDG&E's customers. In the interim the large amount of the balancing account has negatively impacted SDG&E's ability to secure financing. On a combined aggregated basis, the undercollection of the three investor-owned utilities' balancing accounts now exceed $14 billion.

Until recently, there was no evidence that regulators or lawmakers were willing to pass through the true electric commodity costs to consumers. The CPUC has now approved a 4-cent per kwh rate increase, the largest in the state's history, to the customers of PG&E and Southern California Edison. However, this increase is not intended to recover previously incurred debts, but rather to address the ongoing costs being incurred by the DWR, which has been purchasing electricity for the utilities since January and is itself limited in its ability to continue to finance these purchases absent significant rate increases.

The CPUC has not yet granted SDG&E any rate increase, although the company has had a pending application before the agency for several months.

What Can Congress and the Administration Do to Help?

Much has been made in prior testimony to Congress about the state's reluctance, until recently, to take the step of raising retail rates. Some have testified that consumers in California are being subsidized by consumers in other western states. In part, this argument ignores the fact that California's electricity rates are already among the highest in the nation. More significantly, it ignores the question of the wholesale costs that are at the core of the problem.

On November 1, 2000, and again on December 15, 2000, the FERC officially declared that the wholesale prices for electricity in the western region were not "just and reasonable." Under Section 206 of the Federal Power Act, the FERC is required to act to determine and enforce rates that are just and reasonable. This statute is not discretionary. Yet, no action has been taken.

Sempra Energy's Chairman & CEO recently testified before the Senate Energy Committee in support of S. 287, legislation that would order the FERC to fulfill its mandate and impose "Cost of Service Plus" rates in the western region. Sempra Energy has argued for "Cost of Service Plus" rates since the fall of 2000. We believe that the imposition of such rates on existing generation will provide a much needed cooling-off period for California's energy market, and will bring together the key market participants to work together to restructure the market in a way that is fair and reasonable to consumers, generators and utilities. Under 'Cost of Service Plus' rates, each existing generator would provide to FERC the unit cost per kwh to operate its plants. FERC would then include a profit margin to the price per kwh that is high enough to provide generators with an incentive to continue producing energy but low enough to meet consumers' concerns regarding energy prices. Importantly, while avoiding the implementation of a "one size fits all" price cap, "Cost of Service Plus" rates protect both consumers by providing price stability and generators by assuring that plant costs, including a profit, will be fully covered. While opponents of "Cost of Service Plus" rates have argued that a flat cap would be a disincentive to supply, we emphatically disagree. For existing plants, the proposed rates will address the actual costs of operating each plant and provide a reasonable profit. For new plants, there would be no caps, and therefore, no disincentives.

Sempra Energy endorses this concept with the understanding that it is not a long-term solution to the energy crisis. However, when a market is as broken as the western region is today, every reasonable action must be taken to protect consumers. Inaction is simply not an acceptable alternative. The magnitude of the crisis requires an immediate tempering of the market to reach a solution that is fair and reasonable to both electric producers and consumers. Only the federal government, which has jurisdiction over the wholesale cost of power, is in a position to broker this compromise.

I must take a moment to respectfully take issue with the position taken by Department of Energy Secretary Abraham, who has argued against price caps.

As I understand it, part of the Secretary's position is that price caps will create energy shortages. Today, in California and much of the west, we are already experiencing extreme shortages, whether from low hydropower availability or from idled power plants. The reason we are asking the FERC to fulfill its role as "policeman of the market" is that this tight supply will not only threaten outages but will add extreme economic dislocation to the problem if not addressed. We are advocating the imposition, for a short-term period agreed upon by the market participants and the FERC, of "Cost of Service Plus" rates. Such rates avoid the problems of one-size-fits-all caps by ensuring that generating electricity remains a profitable business for the owners of the power plants. New generation facilities should not be subject to such limits. We need to do all that is reasonably possible to stimulate investment in new generation facilities, and new construction of energy efficient power plants should be rewarded by being permitted to charge market rates. Unfortunately, new construction will not arrive in time to prevent supply disruptions in 2001 and mostly likely 2002.

I am concerned that Secretary Abraham and Chairman Hebert are not asking the question: what can be done to mitigate the economic damage to consumers at a time of power outages? Their comments to date suggest that the only path through this current crisis is to let prices be unrestrained in order to maximize the incentive for new generation. But how high do prices have to be to provide this incentive? The twenty-six powerplants now under development in California were all put into motion when wholesale prices for electricity were only in the $50/MWh range and expected to decline even further as additional supply came on line. Clearly the prices now found in the wholesale marketplace are not required for investment.

There is also the claim that the institution of a temporary "Cost of Service" rate by FERC would constitute "changing the rules" and thus be a disincentive to investors. Doesn't FERC also have a responsibility to consumers? This is not changing the rules, this is enforcing them. Until recently, there was never any reason to believe that FERC would allow what it found to be unjust and unreasonable rates to remain in effect. If FERC fails to take action, that failure will be more unsettling to the marketplace, as consumers cannot tolerate this type of market behavior if it remains unpoliced by the federal regulators.

Opponents have also argued that much of the western grid encompasses public power, which is outside of FERC's jurisdiction. SDG&E has challenged this legal interpretation in a recent filing at FERC. Also, much of that power is built to serve the public entities' native load (on a cost of service basis), not to sell into the wholesale market, so much of this argument is misleading. If Congress were to press FERC to fulfill its duty, some key municipal entities have already testified that they would honor the system for the increment of their generation that is surplus and available for sale. Under such a system, the BPA would likely not be a problem actor either. So, this is largely a "red herring" that does not warrant further inaction by FERC.

"Cost of Service Plus" rates will stabilize the market and demonstrate the absurdity of the electric commodity prices we have experienced in California. Unfortunately, it appears that the severity of the high prices has been lost on FERC. Despite skyrocketing electric commodity prices – sometimes as much as $1500 per Mwh for off peak energy, and as high as $2500 per Mwh on peak, to date FERC has not indicated a recognition of the magnitude of the problem. In fact, FERC has allowed the market to continue unfettered, and only recently ordered electricity wholesalers to justify or refund only $124 million in alleged overcharges (5 percent of the amount of overcharges that the California Independent System Operator has identified). The sum identified by FERC only represents rates charged in January and February 2001 during Stage 3 alerts, when electricity reserves fell below 1.5 percent. Equally high prices at times of lower demand, for example, were deemed acceptable by FERC.

I would also like to briefly address the impact of natural gas costs on the costs of generation, since arguments have been made that natural gas prices explain the explosion in electricity prices in California. That is a gross oversimplification of natural gas supply and demand. The interrelationship between the price of natural gas and the magnitude of change in electric commodity prices is terribly out of alignment. For example, in the summer of 2000, the price of natural gas was $3.50 per mcf, yet the electric commodity price was as high as $2000 per MWh. These numbers provide little justification for the skyrocketing electric prices that have been charged in the wholesale market. While some suggest that there has been upward pressure on electric rates as a result of increased natural gas prices allegedly resulting from year round rather than cyclical demand and storage shortages, I have seen no evidence suggesting that current electricity prices have any relationship to cost, high natural gas prices or emission credits. In fact, some believe that high natural gas prices are the result of the skyrocketing electricity prices we have seen in California, rather than the cause of those prices.

SDG&E has urged the FERC to reinstate the cap on secondary market transactions for the short-term interstate transportation of natural gas that it removed on an experimental basis last year because the imputed value of interstate transportation costs is now exponentially higher than the FERC-approved cost of providing this service. Again, FERC has taken no action on this matter.

Conservation:

Electric markets will not work well without demand-side responses. We expect the CPUC's recent action to increase retail rates for PG&E and SoCalEdison to be followed soon by an orderly and predictable relaxation of the retail price caps the Legislature imposed on SDG&E customers through AB 265. The CPUC's proposed tiered-retail design is intended to promote additional energy conservation by penalizing customers who dramatically exceed their baseline usage.

In nearly every competitive market, consumers not only know the prices they pay, they are also able to change their consumption (almost immediately) in response to price changes. Electricity is the exception to this rule. While electric markets produce signals, most consumers never see them. And, if they do see the signals, it is difficult with today's existing technology to reduce demand within relevant time frames when prices rise. Rate designs need to be developed to charge more for increased usage of electricity and we need to enable customers, especially the larger customers, to see on a real time basis the impact of higher usage on the price they will pay for electricity. However, Californians are not profligate energy users. In fact, quite the opposite. Only the state of Rhode Island has a lower per capita use of energy than California. So while we need to do more to increase energy conservation, the explanation for the crisis itself is not that our state wastes energy.

The state and federal government must set an example for load reduction efforts and should work with the business community to develop voluntary demand reduction programs. The Energy Policy Act of 1992 provides mechanisms to enable the federal government (the nation's largest energy consumer) to tap private capital to upgrade outmoded facilities and reap energy and cost savings. However, federal facilities have been slow to take advantage of this law and should be held accountable by Congress for inaction. Clearly, this is an opportunity for the federal government to lead by example. In so doing, it will get upgraded facilities and save taxpayers money on their electric bills. Best of all, this solution does not require a new statute or new funding. It just requires leadership to implement existing laws.

Expedited Siting Procedures:

While the actions being taken at the state government level will help to remove barriers to power plant siting, federal regulatory reforms are also necessary to increase the availability of electricity and natural gas in California and the western region. Congress must hold the Environmental Protection Agency and the U.S. Fish and Wildlife Service accountable for their permitting procedures. These regulatory agencies must be required to meet target timelines, especially for permit reviews. State and federal regulators must work together to help streamline the regulatory process so that the same issues are not raised repeatedly at various stages of the regulatory process, while ensuring compliance with the California Environmental Quality Act and the National Environmental Protection Act.

The federal government can take a leadership role in ensuring that the approval and construction process occurs in a timely manner. The current process allows too many opportunities for individuals to delay the approval process for reasons unrelated to local health and safety concerns. Working with state and local regulators, creative siting solutions (including tax incentives) can be found to mitigate NIMBY-ism. Powerplants and transmission lines may not be popular neighbors, but they are a necessity for the nation's wellbeing and security.

Conclusion:

California's electricity crisis requires the immediate adoption of regulations, policies and legislative actions that balance the need for sufficient supplies of electricity with long term approaches that encourage the development of a market that offers reasonable prices and reliable power supply. California's Governor and Legislature have spent several months focused upon resolving this crisis, and have devoted a special "extraordinary" legislative session to resolving the key issues within their jurisdiction. Sempra Energy and SDG&E have participated in ongoing negotiations with the Davis Administration to determine whether the sale of the utility's transmission system can play a role in resolving the financial crisis faced by the utilities. We are considering every option and course of action to resolve this crisis, but we also need help from the federal government.

Although the energy crisis has captured the President's attention, and he now recognizes the negative economic impact of the crisis on the nation's economy, immediate action is needed by the federal government to protect consumers from the abuses of a dysfunctional marketplace. FERC alone has jurisdiction over wholesale rates, and thus is the only entity able to approve 'Cost of Service Plus' rates and give suppliers an incentive to reduce skyrocketing electric commodity prices. If FERC is unwilling to undertake the necessary action, Congress should pass legislation directing it to help resolve the crisis.

Electricity generation, transmission and distribution are the nation's third largest industry. California is the world's 6th largest economy. It is in everyone's interest to resolve this crisis and create economic stability for consumers and market participants.

Thank you for inviting me here today. I am pleased to answer your questions.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,	
Complainant,	
v.	**Docket No. EL00-95-017**
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange,	
Respondents.	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	**Docket No. EL00-98-016**
Arizona Public Service Company	**Docket No. ER01-1444-000**
Automated Power Exchange, Inc.	**Docket No. ER01-1445-000**
Avista Energy, Inc.	**Docket No. ER01-1446-000**
California Power Exchange Corporation	**Docket No. ER01-1447-000**
Duke Energy Trading and Marketing, LLC	**Docket No. ER01-1448-000**
Dynegy Power Marketing, Inc.	**Docket No. ER01-1449-000**
Nevada Power Company	**Docket No. ER01-1450-000**
Portland General Electric Company	**Docket No. ER01-1451-000**
Public Service Company of Colorado	**Docket No. ER01-1452-000**
Reliant Energy Services, Inc.	**Docket No. ER01-1453-000**
Sempra Energy Trading Corporation	**Docket No. ER01-1454-000**

Mirant California, LLC, Mirant Delta, LLC and Mirant Potrero, LLC **Docket No. ER01-1455-000**

Williams Energy Services Corporation **Docket No. ER01-1456-000**

REQUEST FOR REHEARING OF SAN DIEGO GAS AND ELECTRIC COMPANY

San Diego Gas & Electric Company ("SDG&E") requests rehearing of the Commission's March 9, 2001, order directing sellers to provide refunds or further cost justification for certain January 2001 transactions occurring in the California wholesale electricity markets (the "March 9 Order").[1] SDG&E also seeks rehearing of the subsequent companion notice issued by Director Larcamp, which uses the methodology adopted in the March 9 Order to establish a proxy price for certain transactions in February 2001. As described more fully below, the March 9 Order erred fundamentally in allowing sellers to continue using unrestrained market-based pricing authority to sell energy and ancillary services in a poorly-designed, dysfunctional market at unreasonable and unjust prices during all hours but Stage 3 emergencies. SDG&E urges the Commission to direct on rehearing that all wholesale sales, not just transactions during Stage 3 emergencies, should be subjected to restraints that prevent prices from exceeding the illusive, but court-mandated, zone of reasonableness. Additionally, the Commission should state clearly the legal standards that it believes are relevant to judging whether the recent wholesale prices have been reasonable; provide SDG&E and the other complaining parties with access to the detailed data and the basic elements of due process in order to allow these parties to mount an effective challenge to these allegedly unlawful prices; and clarify whether, and precisely how, the relief provided under the March 9 Order was intended to supplant or supplement previous Commission orders establishing October 2, 2000, as the date for commencement of refunds of those charges that the Commission eventually finds to be excessive.[2]

[1] *Order Directing Sellers to Provide Refunds of Excess Amounts Charged for Certain Electric Energy Sales During January 2001 or, Alternatively, to Provide Further Cost or Other Justification for Such Charges*, 94 FERC ¶ 61,245 (March 9, 2001).
[2] *San Diego Gas & Electric Company, et al.*, 93 FERC ¶ 61, 121 (November 1, 2000).

I. SUMMARY OF ARGUMENT

The Commission has yet to find an acceptable solution for restraining the runaway prices in the wholesale markets serving California. What used to be merely an inefficient and poorly-designed wholesale market that needed fundamental reform to achieve its promised benefits has now disintegrated into a chaotic effort to keep power flowing in real-time at any cost. The record in this proceeding is replete with overwhelming evidence that the poorly-designed California markets have lost all ability to discipline prices now or in the foreseeable future.[3] The Commission's remedial efforts thus far have been ineffective and sometimes perverse. The combined effect of poor market design, ineffective remedial measures, and scarcity caused by transient supply conditions has produced a complete and total breakdown of anything resembling a competitive market. The market meltdown has caused an unprecedented transfer of wealth from consumers to suppliers, and has now metastasized into rolling "black-out" conditions, jeopardizing system integrity, causing significant loss of property, and posing a significant risk to public health and safety.

The Commission must accept this unfortunate reality and proceed immediately to use its considerable regulatory powers to restrain wholesale prices until the structure and design of these markets can be reformed and the Commission is able to find that they are workably competitive. The Commission has allowed its laudable goal of establishing fully competitive wholesale electricity markets to undermine its most fundamental duty under the Federal Power Act – ensuring that wholesale electricity prices are just and reasonable. Paradoxically, the Commission's unwillingness to comply with the law by imposing temporary restraints to keep prices reasonable has now caused significant harm in the court of public opinion to the market-based regulation policies that it has properly sought to advance. The Commission's focused attention on detecting the exercise of

[3] *See* Comments of the California Independent System Operator Corporation on Staff's Recommendation on Perspective Market Monitoring and Mitigation for the California Wholesale Electric Power Market (March 22, 2001), forwarding Dr. Eric Hildebrandt's *Further Analyses of the Exercise and Cost Impacts of Market Power in California's Wholesale Energy Market* (March 2001), and Dr. Anjali Sheffrin's *Empirical Evidence of strategic Bidding in California ISO Real Time Market* (March 21, 2001).

textbook market power by suppliers to the exclusion of all other factors has caused it to fail to appreciate fully the systemic effects caused by poor market design and structure.[4] Moreover, the debilitating effects of the unprecedented high prices are bankrupting every entity forced to stand between supplier and consumer.[5] The Commission must retreat from its untenable, laissez-faire approach to its regulatory duties and commence the journey back toward responsible and lawful oversight of wholesale power transactions in California.

The Commission's March 9 Order invoked price mitigation measures only for those hours when the ISO-controlled grid is in Stage 3 emergency conditions, and only for the ISO and PX short-forward and real-time markets. Until recently, all of the wholesale power transactions serving customers of the three California investor-owned utilities were cleared through the FERC-approved ISO and PX tariffs at market clearing prices. In what appears to be more of an effort to avoid responsibility than to fix the real problems, the Commission set about curtailing use of the visible ISO and PX market mechanisms that were yielding the embarrassingly excessive prices. First, the Commission sought to shrink the ISO's real-time energy market to no more than five percent of the scheduled load through the use of scheduling deviation penalties of up to \$100/MWh.[6] Second, by demanding that the PX implement immediately the \$150/MWh "breakpoint" methodology, the Commission set in motion events that led to the PX suspending prematurely its short-forward energy market on January 31, 2001. Collectively, these two developments have forced most short-term transactions into the opaque bilateral markets, thereby arguably avoiding the reporting requirements and price

[4] Based on this year's January and February prices, the Chairman of the California ISO's Market Surveillance Committee now estimates that the cost of California energy and ancillary services in 2001 may approximate \$70 billion, more than double the \$27 billion spent in 2000, and ten times the \$7 billion spent in 1999. *See A Market (Power) Mitigation Plan for California Electricity Market,* Dr. Frank Wolak, presentation to the ISO Board of Governors (March 15, 2000).

[5] So far, the California Power Exchange and Pacific Gas & Electric Company have declared bankruptcy, but if these outrageous wholesale prices are allowed to continue, more names are sure to be added to the list.

[6] The volume of energy purchased in the real-time market frequently exceeds the Commission-mandated five percent despite the scheduling deviation penalty.

restraints required for sales through the PX and ISO markets, and thus raising the possibility that the Commission might avert its gaze from almost all of the wholesale transactions that are producing the unreasonable commodity costs for California consumers. The Commission's March 9 Order may have served to ease temporarily the staff's administrative burdens inflicted by the ill-conceived $150/MWh breakpoint pricing and reporting mechanism, but it has not produced a legally sustainable resolution of this controversy.

All of the short-run wholesale power transactions serving California consumers – whether pooled or bilateral; real-time or forward; emergency or not – are contaminated to some greater or lesser extent from the structural/design infirmities and transient scarcity conditions that are producing excessive wholesale prices. Yet the March 9 Order proposes to detect the exercise of market power by using a large-mesh "screen" to sift only through the remnants of a largely defunct spot market and only during the most severe emergency conditions. Clearly much more is required in the form of regulatory crutches to assist this disabled market if the Commission hopes to remain within even the broadest parameters of the law. SDG&E urges the Commission to order suppliers to refund, with interest, all revenues that exceed the legitimate fixed and variable costs (plus merchant plant levels of expected return) of generating the power being sold in the wholesale markets serving California consumers. An *ex post* remedy of this type for all periods and all transactions since October 2, 2000,[7] should be used to recoup excessive charges from suppliers until the Commission imposes effective *ex ante* measures that are able to restrain the prices received by existing generators going forward. All price restraints, except for a "circuit breaker" to act as a surrogate for demand elasticity, should then be removed once the California short-forward and real-time markets are re-designed to promote efficient and effective competition and the Commission is able to certify that the markets are workably competitive – that is, when the minimum legal requirements for market-based pricing under the Federal Power Act are met.

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[7] The Commission also has the legal authority and duty to order suppliers to "disgorge" monies received prior to the October 2 refund trigger date if the Commission finds market abuse that is inconsistent with applicable Commission tariffs, including the market-based pricing tariffs that each supplier relies upon to sell into the California markets at non-cost-of-service rates.

The courts have permitted the Commission to use market-based rate making mechanisms only when the Commission can demonstrate that the market is workably competitive and thus capable of generating sufficient competitive pressure on suppliers to keep prices reasonable.[8] The courts have never recognized the Commission's right to use a dysfunctional, broken market to set wholesale prices. In the *Farmers Union* case, the court noted that "[r]ates that permit exploitation, abuse, overreaching or gouging are *by themselves* not 'just and reasonable.'"[9] The court also noted that, although the Commission had assumed that "existing competition would ensure that the actual price is just and reasonable," this assumption was not supported by empirical evidence.[10]

Thus, since its earliest decisions authorizing sales of power at market-based rates, the Commission has recognized, as required by the courts, that the existence of workable competition is necessary to ensure that such rates comply with the just and reasonable requirement of the Federal Power Act.[11] For example, in *Citizens Power*, a case involving the then "relatively new type of seller in the electric power industry: the power marketer," the Commission acknowledged that "[t]o approve Citizen Power's proposed market-oriented rates under the FPA, the Commission must find that they fall within a 'zone of reasonableness.'"[12] Thus, heretofore, the Commission has always recognized that it is, in effect, on a short legal tether in pursuing the use of market-based

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[8] *See Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) ("where there is a competitive market the FERC may rely on market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result"); *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1509 (D.C. Cir. 1984) (invalidating FERC order that relied primarily on market forces to determine interstate oil pipeline transportation rates under the "just and reasonable" standard in the Interstate Commerce Act).

[9] *Farmers Union*, 734 F.2d at 1502 (emphasis in original).

[10] *Id.* at 1510.

[11] *See Citizens Power & Light Corp.*, 48 FERC ¶ 61,210 (1989).

[12] *Id.* at 61,776; *see also id.* at 61,783 (Comm'r Trabandt, concurring) (emphasizing that *Farmers Union* requires the Commission to find that a workably competitive market exists before authorizing market-based rates).

mechanisms to set wholesale rates. But in this instance, the Commission has ignored its consumer protection responsibilities by proposing to invoke remedial price restraints in only the most limited and extreme circumstances. The Commission is placing the entire burden of market failure on consumers, while the law and prior Commission practice has always emphasized reasonable results over political philosophy and a balancing of the competing economic interests.

The Commission must either defend the results being produced by the wholesale markets as just and reasonable, or it must take effective measures to bring the non-complying results within the statutory limits. Many have been critical of state public officials for not raising retail rates to reduce electric demand and attenuate the financial crisis, but that does not excuse the Commission's failure to do its job in restraining wholesale prices to lawful levels. The Commission has ample cost-based tools to establish just and reasonable wholesale prices, and it is armed with the Supremacy Clause of the Constitution, so the wholesale power "buck" stops with the Commission, and no one else.

The Commission has argued from time to time that remedial price restraints would discourage new supply projects, but many price restraint proposals, including SDG&E's, would exempt new supply projects. Moreover, the 14 projects for which the California Energy Commission has granted approvals were all commenced **before** the dysfunctional California wholesale market began producing extreme prices. There is no basis for this Commission's implicit finding that only prices that are unjust and unreasonable will provide an incentive for new generation to be sited in California. For its part, the State of California is pulling out all of the stops in an effort to streamline the siting of new generation projects, and many new projects will be completed in the next several years. The problem is not that suppliers will not build or that the state will not site – the problem is the lack of money from any source to pay the excessive profit margins that existing suppliers are demanding and getting, even for power deliveries in off-peak periods. The Commission's January and February Stage 3 proxy price determinations do not address this issue, and thus fail to offer a remedy that is capable of stanching the red ink flowing out of California.

II. SPECIFICATION OF ERRORS

The March 9 Order, and the subsequent notice of proxy price for February transactions, erred in the following respects:

1. In establishing a \$273/MWh and \$430/MWh proxy "screening" price for measuring whether transactions in January and February 2001, respectively, were excessive, and in proposing to use the proxy price to restrain wholesale prices only in those hours that experience Stage 3 emergencies;

2. In excluding short-run bilateral transactions from coverage, especially short-forward bilateral transactions that would have been conducted in the California Power Exchange's short-forward markets, and thus covered, but for the demise of the Power Exchange because of its inability to implement the now proven to be ineffective \$150/MWh "breakpoint" methodology on the schedule demanded by the Commission;

3. In excluding publicly-owned generators that receive market-clearing prices in the dysfunctional FERC-jurisdictional markets from the *ex post* remedial price restraints that the Commission determines are necessary to protect consumers from excessive costs; and

4. In failing to state and apply the proper legal standards that are relevant to this proceeding, in failing to exercise reasoned decision making, and in failing to observe due process of law in reaching conclusions about the lawfulness of prices that have been charged in the jurisdictional wholesale markets serving California consumers since October 2, 2000, and before.

III. THE COMMISSION ERRED BY ESTABLISHING PROXY "SCREENING" PRICES FOR JANUARY AND FEBRUARY 2000 THAT ARE TOO HIGH, AND BY ARBITRARILY EXEMPTING FROM PRICE RESTRAINTS ALL HOURS NOT EXPERIENCING STAGE 3 EMERGENCIES

The Commission's December 15 Order developed a \$150/MWh breakpoint price mechanism that triggered weekly reporting to the Commission of all transactions higher than the breakpoint. The March 9 Order proposed a proxy price screening mechanism to establish "the market clearing price that would have occurred had the sellers bid their variable costs into a single price auction, which is what would have occurred had there been competitive forces at work."[13] The Commission stands on firm legal ground in establishing this rationale for the proxy screening price, but the illogical implementation measures effectively nullify the stated rationale. It is axiomatic, of course, that the Commission is not permitted to use a market to set wholesale rates unless there are "competitive forces at work," so by applying the proxy screening price only to hours experiencing Stage 3 emergencies, the Commission is implicitly relying upon the unstated assumption that the ISO and PX markets were workably competitive in all other hours. The record of this proceeding prevents the Commission from making any such finding, unstated or otherwise.

If the Commission believes that the markets were workably competitive in all other hours, then it should so state and present the facts to support this position, including an explanation of why prices are frequently higher in non-emergency hours than during Stage 3 emergencies. With the billions of dollars at stake, this very issue – are the ISO and PX markets workably competitive in all hours except Stage 3 emergencies and thus able to set lawful wholesale prices – will be litigated to the highest court in the land. Thus far, only the Commission has seen and analyzed all the data, so the Commission does a disservice by refusing to share completely its thinking and judgment on this critical issue. To date, the Commission has been unable or unwilling to offer a cogent explanation of why wholesale prices have gone up an order of magnitude over the past nine months; has been unable or unwilling to explain the price formation process that is acceptable under market-based regulation; has been unable or unwilling to define the most fundamental terms at issue – such as "workably competitive", "just and reasonable", "market power", "scarcity", and "opportunity costs"; and has been unable or unwilling to implement effective remedial measures to allay the mounting concerns. The Commission has the sole responsibility for policing wholesale power transactions and it has ample authority to protect the public interest. There is simply no justification for allowing these events to continue undefined, unrestrained, unjustified, and unregulated.

[13] March 9 Order at 4.

According to the dissenting statement prepared by Commissioner Massey, 81 percent of the reported "spot" transactions (above the \$150/MWh breakpoint) during January 2001 occurred during non-Stage 3 conditions, and were thus arbitrarily excluded from any price restraint or refund liability. Of these excluded transactions, almost 14 percent were above the \$273/MWh proxy screening price for January.[14] The March 9 Order, of course, offers no reasonable explanation as to why the Commission finds, *sub silentio,* that the wholesale markets serving California are workably competitive and producing reasonable prices in all hours except during Stage 3 hours when the system is on the verge of collapse. Also inexplicable is the Commission's decision to allow prices to exceed the proxy screening price in non-Stage 3 hours, when one would reasonably expect a competitive electricity market to clear at lower price levels because relatively more efficient generating units are on the margin. Given the magnitude of the dollars involved and the important public interest issues at stake, SDG&E is frankly baffled by this highly illogical result, which threatens to tarnish the Commission's reputation for rendering judicious and reasoned decisions.

The Commission, of course, is correct in assuming that market power can be exercised more easily to drive up prices when supply is known to be scarce, such as during Stage 3 emergencies. Moreover, SDG&E agrees that the use of an *ex post* proxy price mechanism to simulate a competitive bid from the marginal generating unit is one reasonable method for establishing an *ex post* market clearing price under such extreme conditions. But how is the public interest served by the Commission validating prices higher than the Stage 3 proxy price during off-peak hours, when no emergency is in effect and more efficient generating units are on the margin? Indeed, the Commission should use a lower proxy screening price to ensure market competitiveness when reserve margins are higher and more efficient generating units are on the margin.

If the Commission wants to use an *ex post* proxy screening price mechanism to restrain the market to reasonable, competitive outcomes, then it should construct several

[14] Comparable figures for February have not been divulged.

demand-related proxy prices reflecting the differing mix of generation likely to be on the margin at different levels of demand, and use these demand-related proxy prices to cap all California short-run wholesale power transactions, including those involving non-public utility sellers, that have occurred since October 2, 2000. Such an approach would be logical and comport rationally with the Commission's stated objective of restraining, but not eliminating, the non-competitive markets currently in place. Alternatively, the Commission could establish a more accurate *ex post* methodology by requiring each seller to refund, with interest, all revenues since October 2, 2000, that exceed the fixed and variable costs – including a merchant plant level of return – of generating the power that is the subject of each sales transaction. SDG&E prefers the use of an *ex post* remedy of this type to recoup excessive charges until the Commission is able to impose effective *ex ante* measures – such as resource-specific, cost-based bid or price caps – that are able to restrain the prices charged by existing generators to reasonable levels until a re-designed market is able to produce reasonable prices.[15] But under no circumstances should the Commission apply price restraints to Stage 3 hours only, while allowing less extreme system conditions to produce higher prices or profits without scrutiny or remedy.[16]

Aside from the many logical lapses associated with the Commission's Stage 3 proxy price mechanism, the Commission has failed to offer a reasoned explanation of its abrupt departure from the price monitoring and mitigation methods outlined in the December 15 Order. SDG&E is unable to discern the underlying thought processes that led to the decision to concoct a new formula, but SDG&E believes the Commission, at a minimum, was ill-advised to have included the NOx costs in the proxy screening price. The NOx costs are significant for only a relatively small number of generators, so SDG&E questions the propriety of including these costs in the proxy price formula to give

[15] *See Comments of San Diego Gas & Electric Company on Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market,* EL00-95-012 *et al.* (March 22, 2001) at 10-11.

[16] SDG&E is not wedded to any particular price restraint method, as long as it is effective. For instance, SDG&E believes the Commission's promise in the December 15 Order that "Functioning Forward Markets Will Be There For California" could have been part of the overall solution, but that promise remains unfulfilled, largely because the Commission has done little to mitigate the short-run market power that shapes the negotiations for long forward contracts. December 15 Order at 26-28.

additional windfall profits to the vast majority of generators that do not have material levels of NOx costs. Consumers would certainly be better off if such costs were to be recovered through an uplift charge, and we doubt that any damage -- theoretical or practical -- would be done to the price formation process.

At the very least, there appears to have been a data input error to the proxy price formula. According to the March 9 Order and the March 16 notice, the \$273/MWh and \$430/MWh proxy prices for January and February, respectively, were calculated by using a January cost for NOx emission credits of \$22.50/lb, and a February cost of \$41.72/lb. These cost numbers appear to be too high. On February 8, 2001, the Southern California Air Quality District issued Executive Order No. 01-03, effectively establishing a price cap of \$7.50/lb for power producing facilities having the capacity to produce 50MW or more. SDG&E believes that the new \$7.50/lb cap applies, at least partially, to the NOx credits for January, so both proxy prices should be restated to reflect the correct number.

It is also inconsistent for the Commission to employ monthly gas prices in its formula. Since the Commission has insisted that the only reasonable course for California utilities to follow is to buy forward and stay out of the real-time markets for at least 95 percent of their requirements, it is only logical to insist that the generators do the same with their own fuel requirements. Therefore, the Commission should employ a natural gas price in the proxy formula that reflects forward purchases at one half or one third the monthly prices for January and February. In general, SDG&E believes that resource-specific *ex ante* price restraints tailored to the actual costs being incurred to produce the power would produce a more accurate price restraint and be better suited to protecting consumers until a re-designed market is able to do the job directly.

IV. SHORT-RUN TRANSACTIONS IN THE WHOLESALE BILATERAL MARKETS SERVING CALIFORNIA SHOULD BE SUBJECT TO PRICE RESTRAINT AND REFUND MEASURES

The Commission has conditioned the market-based rate authority of all sellers into the California markets operated by the ISO and PX, requiring these sellers to remain subject to potential refund liability through December 31, 2002, "in order to ensure just and reasonable rates during the period it takes to effectuate longer term remedies in the markets."[17] Until recently, SDG&E and the two other investor-owned California utilities purchased 100 percent of the power for their "bundled" customers through the various ISO and PX markets, all of which were explicitly protected by the potential refund liability. Then two Commission-initiated events changed things substantially – purchasers in the ISO's real-time market were subjected to stiff penalties for any purchase over five percent of metered load, and the PX "suspended" its markets and quickly sought the protection of the bankruptcy court because it was unable to comply with the Commission's directive that the ill-fated $150/MWh breakpoint mechanism be implemented immediately.

The net effect of these events was to force SDG&E and the other buyers into the short-forward bilateral markets for most of their "net short" power needs.[18] The Commission's orders are vague with respect to whether these short-forward bilateral transactions are subject to reporting requirements or refund liability. If not, then most of the power that has been bought in this broken wholesale market since the demise of the PX are not covered by the refund protections. It would also mean that the Commission's actions have, in effect, eviscerated the very protections that the Federal Power Act has provided, and the Commission has declared to be necessary, to protect consumers from the exercise of supply-side market power.

SDG&E refuses to believe that the Commission intends to leave consumers that are mere pawns in this run amuck market to fend for themselves without the most basic protection afforded under federal law. For certain, the Commission has never stated that the October 2 refund date has been truncated or otherwise limited by subsequent orders or developments at the ISO or PX. Just as in all ratemaking matters, reviewing courts will expect the Commission to reach overall results that balance the competing economic

[17] December 15 Order at 55-58.

[18] All generation owned by, or under contract to, SDG&E is netted against SDG&E's load, leaving a "net short" position that must be purchased in the wholesale markets.

interests. The Commission must not allow suppliers that are already receiving unreasonable prices to slip the refund punch by virtue of an overly-narrow interpretation of the refund condition that the Commission has placed on each sellers' authority to charge market-based pricing in the wholesale markets serving California consumers. Rather, the Commission must review and correct all wholesale transactions serving California consumers that exceed whatever price restraint or refund measure – *ex ante* or *ex post* -- that the Commission determines is necessary to keep prices within a zone of reasonableness.[19] As explained by the Commission itself, any such price restraint or refund measure would only be for the purpose of producing price results akin to what would have been produced by a workably competitive market. No supplier can legitimately ask for more – no consumer can be expected to settle for less.

V. THE COMMISSION ERRED BY FINDING THAT IT HAS NO AUTHORITY TO ORDER NON-PUBLIC UTILITY SUPPLIERS TO REFUND EXCESSIVE REVENUES DERIVED FROM SALES UNDER FERC JURISDICTIONAL RATEMAKING MECHANISMS

The March 9 Order cryptically asserts that the Commission has no authority to order non-public utility sellers to refund excessive charges derived from sales into the ISO and PX markets. This assertion is of no small consequence.[20] SDG&E believes the Commission has ample legal authority to order non-public utility suppliers to refund excessive revenues that are derived from jurisdictional market-based ratemaking mechanisms. The non-public utility suppliers, of course, cannot be compelled to participate in the Commission-jurisdictional wholesale markets, but if they choose to participate, then the Commission is entitled to regulate their participation to the extent necessary to ensure that the overall wholesale cost of power to consumers is just and reasonable. Otherwise, non-jurisdictional participants could contaminate without recourse

[19] The Commission's determinations, of course, must be based on an adequate record and in keeping with principles of due process in order to avoid running afoul of the arbitrary and capricious standard that will be deployed by a reviewing court. So far, the Commission's pronouncements and ineffective remedial measures have failed this most basic test of reasoned decision making.

[20] The Commission does not quantify the extent to which its proposed exemption of non-public utilities would deflate possible refunds, but the ISO has determined that non-public utilities collected approximately $170 million of excessively high charges during January 2001. March 9 Order at 7.

the market-based rate making mechanisms that the Commission has elected to use in lieu of cost-of-service mechanisms that are not so easily influenced by other suppliers.

All sellers in the wholesale markets serving California consumers have been on notice of possible refunds since SDG&E filed its August 2, 2000, complaint initiating this proceeding. On August 23, 2000, the Commission established a prospective date for the commencement of possible refunds, which was later corrected to October, 2, 2000, so no seller can convincingly argue that it had no knowledge that the Commission had found the price formation process to be suspect and possibly in need of remedial measures. These remedial measures can be both *ex ante* and *ex post* – indeed, the Commission has attempted both in this proceeding – and it would be illogical to argue that a non-public utility can be made subject to an *ex ante* "hard" cap (the ISO clears the market at no more than $250/MWh), but not subject to an *ex post* "soft" cap (the ISO clears the market at $250/MWh, but takes and pays higher bids subject to reformation if the after-the-fact justification is wanting). Surely the Commission would not have adopted the "soft" cap breakpoint methodology in the December 15 Order if it had believed this mechanism contained a loophole exempting non-public utility suppliers, which have arguably extracted $170 million of excessive charges from California consumers in the space of 31 days. If the Commission disagrees with the legal analysis advanced here – that the Federal Power Act does not prevent the Commission from reaching a public interest result through *ex post* remedial means that it could have reached through *ex ante* remedial means – then it should act on rehearing of the December 15 Order to remove the self-inflicted limitation. Failure to correct this alleged loophole would be especially egregious in this instance, because some of the non-public utility suppliers involved are likely to be agencies of the Department of Energy, an entity that is supposed to be helping to stabilize this crisis, not throw gasoline on the bonfire.[21]

[21] The Commission must also be mindful that exempting non-public utilities from price restraint measures will encourage public utilities to avoid price restraints by laundering transactions through the non-public utilities.

The Commission has recently recognized that it has broad powers to reach workable results when dealing with non-public utilities that seek to participate in jurisdictional rate making processes, and thus affect the outcomes for jurisdictional utilities. In the *City of Vernon* decision,[22] one of several decisions that collectively have established the conditions governing Vernon's role as a non-public utility "participating transmission owner" under the California ISO, Vernon and other non-public utilities argued on rehearing that the Commission had exceeded its authority by attempting to "determine whether [Vernon's] proposed rate methodology, in the context of participation in a Commission jurisdictional public utility ISO, will result in a just and reasonable component of the ISO's rates."[23] The Commission rejected the non-public utility position that the Commission had exercised impermissible rate making under sections 205 and 206, stating that the Federal Power Act requires the Commission "to ensure the justness and reasonableness of the ISO's rates, and we cannot reach this result if we absolve from our review the portion of the ISO's costs incurred with respect to Vernon."[24]

The Commission's pragmatic and persuasive reasoning in the *Vernon* decision is directly applicable to the issue of whether the Commission can review the justness and reasonableness of prices paid to non-public utility generation under a jurisdictional market-based rate making mechanism. Once the non-public utility chooses to participate in these market-based mechanisms, it perforce accepts and submits to the Commission's authority to ensure that the resulting rates are just and reasonable. In this instance, the Commission has chosen to develop and apply an *ex post* proxy screening price to determine whether rates have been excessive and thus unlawful. This remedial mechanism would be rendered materially ineffective in ensuring that the jurisdictional rate making mechanism produces just and reasonable rates if non-public utilities were allowed to participate without accepting the same refund obligations that other sellers

[22] California Independent System Operator Corporation and City of Vernon, California, *Order Denying Rehearing*, Docket Nos. ER00-2019-003 and EL00-105-002, 94 FERC ¶61, 148 (February 21, 2001).

[23] *Id.* at 3.

[24] *Id.* at 5.

face. In short, the non-public utilities cannot have it both ways – they cannot accept the prices from the jurisdictional market-based rate making mechanism without accepting the concomitant refund obligations when these mechanisms malfunction and produce unlawful prices.

The Commission must exercise the full extent of its authority to police the California wholesale prices that now greatly exceed anyone's previous estimation. Inherent and fundamental to any market-based rate making mechanism is a provision for potentially recouping excessive charges that could arise through no fault of any particular supplier – the excessive charges could arise because of the anti-competitive conduct of other suppliers or merely because of a market design that is insufficiently robust to remain competitive under certain conditions. Once non-public utilities commingle their bids with other suppliers, then the Commission must insist that the integrity of the jurisdictional market-based rate making process be protected with safeguards that are not rendered partially illusory by exempting the non-public utility suppliers from being held accountable for refunding excessive charges. Instead, the Commission must regulate these voluntary suppliers to the extent necessary to protect the jurisdictional rate making process and the consumers that depend upon these processes to establish just and reasonable rates, which, in this instance, requires mandatory refunding of all excessive revenues reaped through participation in the malfunctioning market.

VI. THE COMMISSION ERRED BY FAILING TO EXERCISE REASONED DECISION MAKING AND BY FAILING TO OBSERVE DUE PROCESS OF LAW IN VALIDATING WHOLESALE TRANSACTIONS NOT COVERED BY THE PROXY SCREENING MECHANISM

The March 9 Order and subsequent March 16 notice appears to validate as just and reasonable – and thus beyond possible refund liability -- all wholesale transactions during the months of January and February 2001 that are not inconsistent with the proxy screening mechanisms. There is, however, some doubt on this point, because the Commission's order and notice do not speak affirmatively on this matter. One must deduce this conclusion by noting what is not stated or only partly stated.[25] Thus, obliquely, tersely, and by implication and negation, the Commission appears to be informing California consumers that only a relatively few transactions that occurred during January and February will be subjected to further review for possible refund liability. With billions of dollars at stake, and the Commission's policies that seek to expand the use of market-based regulation in danger of being swept away by aroused and shocked consumers, SDG&E expected the Commission to proceed forthrightly with this investigation, and to craft well-reasoned orders that are based on substantial evidence and that produce results that comport with law and the overall public interest. Our expectations have not been met.

The Commission's December 15 Order stated that it would review all transactions above the $150/MWh breakpoint, promising to look at outage rates, withholding, and bidding patterns to determine whether the market is producing just and reasonable prices. There is no record evidence that this analysis has been completed, or even attempted, yet the Commission rushes to validate the results flowing from a hopelessly broken market. The Commission has denied to SDG&E and other buyers the most basic elements of due process – no rights of discovery or even access to basic data; no rights to learn and challenge the hidden facts and theories that might be driving the staff's recommendations and the Commission's decisions; no right to present evidence before an impartial judge and to cross-examine opposing witnesses seeking to justify these wholesale prices; and

[25] For instance, the Commission's determination that "bids for certain transactions into the California ISO and PX markets have not been shown to be just and reasonable" (March 9 Order at 3) [apparently meaning that some have been shown to just and reasonable]; or footnote 14, which affirms that the "Commission has not yet addressed refunds for the period October 2 to December 31, 2000" (March 9 Order at 7) [apparently meaning that the Commission has addressed definitively the issue of refunds for January and February, 2001]; or footnote 3 in Commissioner Massey's dissent, which notes the confusion but infers that the Commission has not tolled the 60-day notification period that would exempt from refund liability all transactions not specifically identified and subjected to further review (March 9 Dissent at 3).

thus far no rights to appellate review to establish the controlling law.[26] The Commission orders in this proceeding have been noteworthy for their failure to explain forthrightly why the wholesale market results are lawful and should be left largely undisturbed by the Commission's remedial powers. Meanwhile, the unexpected wealth transfer approaches $20 billion and counting, utility companies are being destroyed, economies wrecked, and a crisis of unprecedented dimensions is allowed to fester.

The Commission's remedial efforts have been largely ineffective – even perverse more often than not – in assisting the California wholesale markets to function more efficiently and effectively. The Commission's orders in this proceeding are candidates for a case study in the law of unintended consequences, *ad hoc* reasoning, unseemly finger-pointing, and the general lack of understanding of the technical, legal, economic, and political premises that underlie market-based regulation of the wholesale electric industry. The Commission steadfastly refuses to consider price restraints to stabilize the dysfunctional market, reportedly because price restraints will not "increase supply and or decrease demand." Glib slogans of this type just underscore how far the Commission has strayed from reasoned decision making worthy of deference from a reviewing court. If the Commission intends to stay its current course, then it should at least act quickly on the pending rehearing requests so that judicial review of this sorry state of affairs can proceed without further delay.

Congress has not changed the "just and reasonable" standard that has governed wholesale rate making since 1935, yet the Commission is functioning as if Congress has directed the Commission to stand aside once a spot market has become operational no

[26] So far, the DC Circuit Court of Appeals has rejected efforts to obtain expedited review of the Commission's December 15 Order in this proceeding, but the Court did express its expectation that the Commission would act promptly on the pending requests for rehearing -- "We anticipate that the Commission will rule on the rehearing petition in a timely manner." *Per Curiam* opinion, No. 00-1543, (D.C. Cir., January 5, 2001). Significant time has now elapsed since the Court spoke, but the Commission has not acted on rehearing, choosing instead to issue additional orders such as the two being examined here that are not yet ripe for review. The Commission would further the public interest if it were to act promptly on all pending rehearing requests so that the legal challenges to the Commission's orders can be mounted without further delay. In this instance, given the Commission's pronounced inability or unwillingness to deal effectively or lawfully with the growing crisis caused by the high wholesale prices, SDG&E believes that only a reviewing court will be able to state the applicable law and direct the actions that are needed to bring wholesale electric rate making affecting California within the ambit of lawful options.

matter what the results. The reviewing courts have acknowledged that the Commission is not confined to using cost-of-service rate making, but have been quite clear in stating that the rates produced by market-based mechanisms must meet the same standards as rates produced by more conventional means. SDG&E believes the Commission has plenary jurisdiction over wholesale electricity rates, and is therefore mystified by widely-reported statements emanating from the Commission to the effect that the high prices for wholesale electricity in California are California's problem and must be remedied under California law by California public officials. Under our understanding of the law, only the Commission is lawfully charged with regulating wholesale electricity rates, and only the Commission will have to answer to a reviewing court if a poorly-designed market has been allowed to produced unreasonable wholesale prices without refund and without other effective remedial measures being taken to circumscribe the damage to consumers.

If the Commission believes that SDG&E is using the wrong legal standard to judge the Commission's performance during this economic disaster, then it should speak on the record to educate SDG&E and the rest of the country about the Commission's understanding of the law and why the Commission's actions have been consistent with its duty under that law. SDG&E's interest is not academic – we believe the Commission is shirking its legal duty and greatly aggravating a problem that would at least have been manageable had the Commission's understanding of its legal obligations been different from what it seems to be. Until the Commission's understanding of its role in policing the emerging wholesale competitive markets undergoes a significant change – away from hands-off deference to dysfunctional market results and towards responsible market-based regulation – SDG&E sees no prospects for stabilizing the economic crisis and salvaging broad-based acceptance of the Commission's policies to establish market-based regulation of wholesale electricity prices.

Given the strong difference of opinion that has arisen about the nature of the Commission's legal responsibilities, including the publicly-aired differences amongst the Commissioners themselves, the only course that seems capable of producing progress at this point appears to be fresh ideas injected by judicial review. By failing to act timely on requests for rehearing of the Commission's December 15 Order – and by taking non-justiciable piecemeal actions like the proxy price orders – the Commission is effectively frustrating even that remedy.

VII. CONCLUSION

The Commission must reverse course by rejecting on rehearing the rationale and results presented in the March 9 and March 16 proxy price decisions. As applied, the proxy price mechanism is entirely inadequate to transmute the results of this dysfunctional market into lawful wholesale rates. The Commission's failure to take effective measures to stabilize the wholesale markets is harming consumers, the Commission's reputation for judicious and reasoned decision making, and the very markets that the Commission seeks to establish on a firm footing. The Commission has not given serious consideration to the various cost-based remedies that could be deployed to restrain prices until a re-designed market is able to function. Events are spiraling out of control and will soon be beyond the powers of this Commission to remedy.

Respectfully submitted,

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April 9, 2001

Mr. MALCOLM. Mr. Chairman, I want to thank you again for the opportunity to offer Williams' views on the urgent actions that are necessary to minimize the stress that Californians will face this summer because of energy concerns.

First, a little background on Williams. Williams is a publicly traded, diversified energy company that is active in most parts of the domestic energy industry through various operating subsidiaries.

We are the second largest natural gas pipeline company in the United States, transporting about 17 percent of the Nation's peak day consumption through five wholly owned pipeline transportation and storage systems. This network does include our Kern River pipeline which just received expedited approval to add a substantial amount of new capacity to California for this summer.

Many people outside our industry are just now becoming aware that we also have a large and rapidly growing energy marketing and trading group.

In the electricity area, we market about 15,000 megawatts of installed and planned generating capacity around the country, and intend to grow that portfolio to about 40,000 megawatts over the next 5 years.

Here in California, we dispatch roughly 4,000 megawatts from three plants in the Los Angeles area. And as you all know, that represents about 10 percent of California's peak day demand. And we sell the majority of our megawatts through forward contracts.

Key elements of the Williams message are unchanged and are consistent with what we have been saying in California and in Washington since early last summer. In the few minutes I have today, while I want to update you on the most recent actions by the company, I will focus primarily on the most urgent and immediate actions we think are necessary based on today's circumstances.

I want to emphasize, our focus is and has been on developing solutions to the real problems. In fact, Williams has worked closely with State and Federal Government officials to develop solutions toward that end. Despite the decision by PG&E last week, Williams has refrained from taking action to force utilities into bankruptcy. We were at the forefront of the initial movement to postpone due dates for payments in January. Since then, Williams has continued to sell power to the ISO voluntarily, despite the mounting unpaid bills. Williams has used its own credit and liquidity to buy power outside the State, and then resell it to the ISO at the ISO's request during the period when many out-of-state generators refused to sell to the ISOs. Williams signed one of the first long-term contracts with the Department of Water Resources earlier this year, and most recently, as I mentioned earlier, we worked diligently and urgently to get approvals necessary to expand the capacity of our Kern River pipeline to bring more natural gas to the State by this summer.

Looking first at some much needed near-term actions, it is absolutely critical that we remove every obstacle to utilizing all existing generation, and to adding new generating capacity this summer. First, the dampening of new development caused by regulatory uncertainty and the financial instability of major purchasers in the market must be removed. Credit-worthy counter parties with the flexibility to take advantage of risk management tools must participate in the wholesale market to obtain supplies for end use customers.

Last summer we actively encouraged California regulatory agencies to follow the utilities to add long-term—to allow the utilities to add long-term contracts to their power portfolios. Fortunately, the Department of Water Resources has recently had some success in this area, and including an arrangement with Williams. But there are important issues that remain unaddressed, not the least of which is a solution of the problem of past due payments.

Second, the permitting and approval process for new generation needs to be streamlined and improved. The good news is that we have seen some progress, but clearly the processes leading to project approval still need more attention.

We have been monitoring with particular interest an application at Huntington Beach that would take an existing site and add 450 megawatts by revitalizing old, out-of-commission units. The developer has estimated that it will take 3 months of 20-hour days to get that power online. But the construction has yet to commence, as the developer tries to work his way through a long list of obstacles.

Third, and certainly a tough choice, is that a significant amount of power can be available only if certain environmental regulations are suspended. Power plants that have specific limits on the number of hours that they can run may already be over the limit because of strains on the system last year and in the first quarter of 2001. Rules must be clarified to allow those plants to run and make that power available, and not just under Stage 3 conditions.

Further, these changes must be made in a way that does not put greater pressure on prices, nor mortgage the future of those facilities.

And finally, we must have a significant demand side response. Painful as it is, the fact of the matter is that consumers must be exposed to price signals before they will reduce consumption in a meaningful way, just as suppliers and potential suppliers must receive appropriate price signals to encourage development.

Looking now at some of the longer-term solutions, to avoid us having to be back here again next year, again accurate price signals are the most effective means of attracting the investment in new generation and new transmission that is essential. We must take actions to facilitate the integrated planning operation and upgrading of the electric transmission grid. The answers in this area must be developed on a regional, not a State basis.

And I would just conclude by saying we certainly appreciate the opportunity to share our views, and look forward to being a constructive part of finding a solution. Thank you.

Mr. BURTON. Thank you, Mr. Malcolm.

We will now hear from Mr. John Stout, senior vice president for asset commercialization for Reliant Energy.

[The prepared statement of Mr. Malcolm follows:]

Testimony of Steve Malcolm

House Committee on Government Reform

April 12, 2001

Good morning, Mr. Chairman and Members of the Committee. I am Steve Malcolm, Executive Vice President of Williams and President of our Williams Energy Services unit, the group that includes our electricity production and marketing activities. Personally and on behalf of the 23,000 Williams employees around the country, I want to thank you for this opportunity to again offer our views on the urgent action that is necessary to minimize the stress that Californians will face this summer because of energy concerns.

And let me be very clear on that key point from the outset: most likely things are going to be tense, to say the least, in California this summer despite our best efforts to date and going forward. For that reason, I appreciate the time this committee is devoting to this topic, and will be suggesting to you some urgent, immediate action that I believe local, state and federal government must consider to restore the health of the electricity system in the state.

WHO IS WILLIAMS?

Williams is a publicly-traded, diversified energy company that is active in most parts of the domestic energy industry through various operating subsidiaries. We are a top 25 independent exploration and production company. We are among the largest North American natural gas gathering and processing companies. We are the second largest natural gas pipeline company in the United States, transporting about 17% of the nation's peak day consumption through five wholly-owned pipeline transportation and storage systems that literally span the country in all directions. This network includes our Kern River pipeline, which just received expedited approval to add a substantial amount of new capacity to California for this summer. We own two refineries in the United States and are a major distributor of petroleum products through a refined products pipeline and a national terminal network. Many people outside our industry are just now becoming aware that we also have a large and rapidly growing energy marketing and trading group. In the electricity area, we market about 15,000 megawatts of installed and planned generating capacity around the country and intend to grow that portfolio to about 40,000 megawatts. Here in California, we dispatch up to roughly 4,000 megawatts from three plants in the Los Angles area. That's nearly 10% of California's peak day demand. These are plants owned and operated by subsidiaries of the AES Corporation, but Williams supplies fuel and markets all the power from those plants. Williams sells the majority of its megawatts through forward contracts.

We believe this range of activities and experience in the energy business gives us a good platform from which to understand both the current problems in the California power markets and an informed pathway towards correcting those problems.

I know that Keith Bailey, the chairman of Williams, appeared before a Senate committee earlier this year, and Cuba Wadlington, who heads up the interstate gas pipeline group at Williams, has also spoken to another House committee engaged on this issue. The group I head is more specifically focused on electricity and energy products and services other than natural gas transportation, but key elements of the Williams message are unchanged, and are consistent with what we have been saying in California and in Washington since early last summer. In the few minutes I have today, while I will update you on the most recent actions that we have undertaken, I will focus primarily on the most urgent and immediate actions we think are necessary based on the circumstances we find ourselves in, now in April.

Unfortunately a great deal of the media coverage, and even the attention of key government entities, has been focused on the past or on trying to find somebody to blame for the current situation. Williams is one of the various independent electricity providers that the FERC has ordered to provide refunds to California for spot market sales during peak periods in the past few months. I hope that you are aware of and understand Williams' decision to contest the FERC's refund order – which we believe has ongoing policy implications, to the detriment of the California markets, that demand our response.

WILLIAMS' INVOLVEMENT IN SOLUTIONS

Williams of course has and will continue to cooperate with any investigations about our rates and business practices; but I want to emphasize our focus is and has been on developing solutions to the real problems. In fact, Williams has worked closely with state and federal government officials to develop solutions towards that end. Despite the decision by PG&E last week, Williams has refrained from taking action to force the utilities into bankruptcy. We were at the forefront of the initial movement to postpone due dates for payments in January, when we were led to believe that solutions were forthcoming. Since then, Williams has continued to sell power to the ISO voluntarily, despite the mounting unpaid bills; Williams has used its own credit and liquidity to buy power outside the state and then resell it to the ISO – at the ISO's request, during the period when many out-of-state generators refused to sell to the ISO; Williams signed one of the first long-term contracts with the Department of Water Resources earlier this year.; and most recently, Williams has worked diligently and urgently to get approvals necessary for us to expand the capacity of our Kern River pipeline, to bring more natural gas to the state by this summer.

Others among our competitors have taken different steps as they have seen fit. But I am here today to urge government agencies to do what we as providers of electricity service cannot do on our own. Unfortunately, despite your best efforts things are going to be very tough this summer. But federal and state government can take actions to mitigate the stress of this summer, and to hasten the solutions that will keep us from facing this same level of stress next summer and the summer after that.

NEAR-TERM ACTIONS

It is absolutely critical that we remove every obstacle to utilizing all existing generation and to adding new generating capacity this summer, which could be available by retrofits or upgrades to existing power plants. First, the dampening of new development caused by regulatory uncertainty and the financial instability of major purchasers in the market must be removed. Credit-worthy counterparties (either private or public), with the flexibility to take advantage of risk management tools, must participate in the wholesale market to obtain supplies for end-use customers. Last summer, Williams actively encouraged California regulatory agencies to allow the utilities to add long-term contracts to their power portfolios. Fortunately, the Department of Water Resources has recently had some success in this area, including with Williams. But there are important issues that remain unaddressed, not the least of which is a solution to the problem of past due payments for services that have already been provided. Suppliers must be paid past due amounts if this market is to return to any kind of orderly function.

Secondly, the permitting and approval process for new generation needs to be streamlined and improved. The good news is that we have seen some progress on this front, but clearly the processes leading to project approval still need more attention. We have been monitoring with particular interest an application at Huntington Beach that would take an existing site and add 450 megawatts by revitalizing old, out of commission units. The developer has estimated that it will take 90, 20-hour days to get that power on line. But that construction has yet to begin, while the developer tries to overcome obstacles: local rules which prohibit construction before 7:00 a.m. or after 8:00 in the evening; air quality officials who are only willing to approve the project to operate for 5 years; requirements that all power from the units be solely for use in California; and a demand that the developer pay into escrow a million dollars in the event that some government agency can prove harm to the environment down the road. Clearly this is a situation that presents us with choices – the kind of tough choices that must be made to harness every megawatt of power that could be available this summer.

Thirdly, and another tough choice, is that a significant amount of power can be available only if certain environmental regulations are suspended. Power plants that have specific limits on the number of hours they can run may already be over the limit because of strains on the system last year and in the first quarter of 2001. Rules must be clarified, if not modified, to allow those plants to run and make that power available, and not just under Stage 3 conditions. Further, these changes must be made in a way that does not put greater pressure on prices or mortgage the future of facilities. It must be clear that plant operators will not face legal threats from environmental agencies when asked by the ISO to help preserve reliability on the grid. Further, with water reservoirs in the West and Northwest now estimated at only 60% of their normal levels, those California plants must be available as an alternative throughout this summer, at the least, to help us avoid premature drawdown of hydroelectric resources from outside the state.

And finally, despite our best efforts to improve supply, we must have a significant demand side response. Painful as it is, the fact of the matter is that consumers must be exposed to price signals before they will reduce consumption in a meaningful way – just as suppliers and potential suppliers must receive appropriate price signals to encourage development. While this point sounds self-serving coming from the generator/marketer community, it is clear to me that there will be a demand response in California this summer one way or the other: What we seek to minimize is the chaos associated with blackouts.

LONGER TERM SOLUTIONS

And the best way to avoid extending this problem to next summer and the summer after? Again, accurate price signals are the most effective means of attracting the investment in new generation and new transmission that is essential. As urgent as the situation is this summer, you must take actions with an eye beyond this summer. Certainly plants that are already under construction, and some that are in the final stages of certification, will be finished. But there are yet other waves of investment which we must be immediately marshalling, or we are simply guaranteeing ourselves that we will be holding these same hearings and participating in these same discussions in the years to come. We must not take actions that discourage private investment in new generation resources.

Further, we must take actions that facilitate the integrated planning, operation, and upgrading of the electric transmission grid. The answers in this area must be developed on a regional, not a state basis. Clearly the most efficient utilization of available generating resources involves flow of power into and out of California from neighboring states. A regional approach to grid management is critical.

The independent power merchants are an easy target when you want to fix the blame for the energy situation we are facing here in California. Williams has proven its commitment to being part of the solution to the energy crisis in California, and we have customers around the country who have taken advantage of the energy services we provide, to avoid their own version of this crisis. But we are limited to our good faith efforts in the context of the laws and regulations that are in place. I have given you my candid observations on actions that must be taken by local, state and federal government agencies, on behalf of the consumers of this state. I urge you to use your influence to encourage them to make those choices as quickly as possible.

Mr. STOUT. Thank you very much, Chairman Burton. First of all, let me say I am an engineer by profession and I like to deal with the cold, hard facts. And so I have chosen to use some slide presentations to help illustrate some of the facts that we developed to try and explain what took place this year.

Originally in the package that has been handed out to you, you had several slides dealing with the supply demand situation. I am going to skip those and go straight to the heart of a couple of important issues.

This is a slide that represents how much generation we produced from our facilities over the last 5 years. Now, we only owned these the last 3 years. Before that they were owned by Southern California Edison. What I would like to point out is that in year 2000 we produced two-and-a-half times as much energy from these facilities as they historically averaged in the past.

Couple of points about that. No. 1, in respect to a comment made by Congressman Hunter about the extensive outages we are having now, a lot of that has to do with these extra hours that we ran on these units. We do not have a single power plant that is less than 20 years old, and we have a couple of them that are nearly as old as I am. They were built in 1953. So we have a very old fleet. And it is kind of like taking a 20 or 30-year-old automobile and putting about 50,000 miles in 1 year on that car. At the end of that year you are going to have a lot of maintenance and a lot of repairs that you have to do. And this slide tends to illustrate that.

The other point I would like to make—go back to that slide. I think you skipped ahead. Is that I need to ask the question: Does this really look like the strategy of a business who is trying to withhold energy from the market? We produced two-and-a-half times as much as the historical average. I would argue that is totally inconsistent with someone who is trying to withhold. If you would, skip the next two slides. One more.

Congressman Filner pointed out a comment a minute ago in his opening statement about a $20 billion outflow from California. That is a reflection of the increase in market prices in California, which went from $5 billion in 1998 to $7 billion in 1999 to $27 billion in year 2000. And what I would like to illustrate to you is that when you look at how much money an independent generator such as Reliant had to spend on natural gas for fuel, our cost actually went up 50 percent more than that.

Our costs are up 738 percent from what we spent for fuel in the year 1998. Now, the gentleman from the hotel industry commented that their fuel bills have gone up, too. Theirs have only gone up 350 percent, he said. Ours have gone up more than double that. That is not a market manipulation, that is just a cost of doing business.

And in response to another comment made by Congressman Filner about how well the old regulated system worked, I would point out that even if you had the old regulated system and you had this sort of increase in the amount of usage of gas-fired generation and those sort of gas price increases, even the regulated utility would see similar increases in their cost of producing energy.

Because of these increases, fuel now takes two-thirds of every dollar of revenue that we take in. Two years ago it was 45 percent;

now it is 65 percent. Not a whole lot that I can do about that. That money comes in, goes right back out to the fuel suppliers.

I would like to point out, though, that in trying to be part of the solution to this problem, Reliant has offered—has made this offer to every one of the IOUs, to DWR, even to the Governor's office that we will provide energy for 2 cents a kilowatt hour for the next 5 years. All you have to do is bring the fuel to us. We will cook it, make electricity out of it. We are not trying to gouge California consumers, we are trying to be part of the solution. And 2 cents is a very reasonable price for converting that gas into electricity. But it highlights the fact that the cost of that gas is a critical element of the high cost of power in California right now. That offer is still on the table. So far no one has taken us up on it.

Now, I would like to get into something that I hope you find quite interesting. It has to do with the fact that there are some people who have been raising their bid prices in this market. And I would like to show you a little bit of the detail that explains exactly who they are. If you would flip to the next slide, please.

This slide shows what the PX day-ahead market supply bids looked like on June 29, 2000. This is what suppliers such as Reliant bid in. The PX adds them all up and produces a big curve like this. We do not set the price in the market, though. You actually have to have people who are buying power also put a bid in as to what they are willing to pay. And if you will flip to the next slide, you will see what was bid in.

These were the bids from the buyers in the market. And the point where those two curves cross, which is about $175 a megawatt hour, reflects the clearing price in the market for that hour. Now, I picked June 29th, because that is the very date that the CPUC Chairman Loretta Lynch highlighted her report to the Governor as a day that illustrated market manipulation, withholding. Her argument is that the price at 5 p.m. had jumped to $750 a megawatt hour. And her contention was that perhaps this is evidence of suppliers withholding from the market.

Now, if that was the case, and I were to show you the bid curves that were submitted by suppliers at 5 p.m., you would see that red line that stretches up to the right-hand side of the sheet, you would see that shift to the left. That means less supply was being offered into the market. Let me show you now what actually happened. Next slide, please.

The supply curve did not shift to the left, it shifted to the right. Suppliers offered more supply into the market at even lower prices. So why did the market clear at $750 a megawatt hour? Next slide, please.

Because the buyers in the market raised their bid prices. You can see from this that the supply cleared at $750 a megawatt hour. And if you will flip to the next slide, this shows you the whole bid curve for those 2 hours. It is pretty clear who raised their bid prices in this market. Next slide, please.

This is a slide those of you in Washington have seen before. Excuse me?

Mr. BURTON. Who raised their bid prices?

Mr. STOUT. It is the buyers. But I do not have information as to which specific buyers it was. That is considered confidential.

Those of you in Washington have seen this slide, I think. It was passed around as evidence of the sort of problem in the market. Shows much, much higher prices on a day. In fact, this was a Sunday. I went back, researched exactly which day this was. And if you will flip to the next slide, that is what the bid curves looked like on that day. Once again, the exact same pattern of buyers bidding the price up, which is consistent with any auction where you have a scarce resource.

I actually have with me a binder with every single day this summer. Pick any day you would like to look at, I will be happy to show it to you, because you will see exactly the same pattern of buyer bid behavior.

And let me close by explaining why this takes place. Next slide, please. Because this is a competitive auction, but the competition, because you had a shortage of supply, was existing between buyers, not as much between suppliers. Buyers were working against one another to try and get scarce resources. And what made it especially worse were the rules that were in place in California that require the utilities to bid all of their own generation into the market, because what they had to do then was bid back into the market to get that generation for their own use. It was equivalent to having to put your house on the auction block every day, and having to outbid every other home buyer that came along just so you could stay in your own house.

The quote you see here is from a CPUC audit of PG&E, trying to investigate what happened last summer. And it pretty well explains the situation. And with that, I conclude my opening comments.

Mr. BURTON. Thank you very much. We will now go to 5 minute rounds of the questions.

Mr. Madden, in your March 14th order regarding the AES, Southland, and Williams, you essentially concluded that they intentionally shut down two plants where they were going to receive about $63 per megawatt hour. As a result, the power had to be purchased from other AES units right next-door at more than 10 times the price. Is that a fair characterization?

Mr. MADDEN. Yes.

Mr. BURTON. If they did that, is that illegal?

Mr. MADDEN. They violated—in the March 14th order, which is a show cause order where we essentially tell AES/Williams to prove otherwise, if they do not prove otherwise, it is a violation of 205 of the Federal Power Act and the tariffs at the Commission.

Mr. BURTON. Under your order, AES and Williams were given 20 days to contest that finding. That time period should run out I guess on Tuesday. Have they done so?

Mr. MADDEN. They have submitted additional filings with the staff, the enforcement staff, and have had discussions with them.

Mr. BURTON. In your order, you stated the information suggests that Williams took action to extend the outage at Alamedas, and to make Huntington Beach Two unavailable for pretextual reasons. What does that mean?

Mr. MADDEN. What I believe, that what they meant behind the order is that they did not necessarily have to have that outage at that plant.

Mr. BURTON. What led you to believe that the outages at the two plants were not directly related to the necessary and timely maintenance of the units?

Mr. MADDEN. Mr. Chairman, there is confidential information in the record which demonstrates otherwise, we believe.

Mr. BURTON. Well, we would like to have that confidential information, and I think I have talked to the director, the president—what is his title? Mr. Hebert. I cannot remember——

Mr. MADDEN. The Chairman?

Mr. BURTON. Yeah, the chairman. The chairman. And he said that they would give that to us. The confidential information we will keep confidential. And if a subpoena is required, you let me know and I will issue a subpoena.

Mr. MADDEN. Yes, Mr. Chairman.

Mr. BURTON. OK. Now, to Williams, why were the Huntington Beach Two and Alamedas Four units shut down in April and May 2000?

Mr. MALCOLM. First, I would like to start by saying we take these allegations very seriously. We believe very strongly in doing the right thing, treating people fairly, maintaining a very high level of integrity. Integrity——

Mr. BURTON. Why were——

Mr. MALCOLM. Excuse me?

Mr. BURTON [continuing]. Why were they shut down?

Mr. MALCOLM. Well, they were shut down because of needed maintenance. There was a tube leak, there was a water cooling tunnel that needed work. There was a boiler that needed repair work done on it.

Mr. BURTON. Can you document all that?

Mr. MALCOLM. Yes, we can.

Mr. BURTON. Well, we want to have those documents. And if I need to, I will subpoena them. Because if they were—if that is a real reason for the shutdown, then that makes some sense. But we want documentation to that effect, to make sure that is what happened.

Is $63 a megawatt hour a good estimate of your variable costs?

Mr. MALCOLM. I am really not sure.

Mr. BURTON. $63. Well, that was the price quoted in what?

Mr. MADDEN. Mr. Chairman, that was the price quoted in our March 14th order, at $63 a megawatt hour.

Mr. BURTON. OK.

Mr. MADDEN. Versus the 750 bid price, or close to it, that——

Mr. BURTON. But that was a good estimate on the plants that were up and running, that they shut down?

Mr. MADDEN. I have not heard anything to the contrary.

Mr. BURTON. To Williams, could you give us an estimate of your fixed cost per megawatt hour at those two plants?

Mr. MALCOLM. No, sir, I do not have that detail.

Mr. BURTON. Well, we want that, too.

Mr. MALCOLM. All right.

Mr. BURTON. Setting aside the question of whether you intentionally shut down these units, explain to us how it is that you were charging a price that was 10 times your cost.

Mr. MALCOLM. I think the circumstances at the time were that we had to take those facilities down. Those were RMR units that had to be taken down. And we simply bid into the market, and the market allowed us to capture the higher rate.

Mr. BURTON. Did you ever charge prices of more than $750?

Mr. MALCOLM. I do not know.

Mr. BURTON. Well, according to our information, that your prices got as high as $1,500 per megawatt hour at some times. And you do not know about that?

Mr. MALCOLM. No, sir, I do not have those facts in front of me.

Mr. BURTON. How much profit did you make in the year 2000?

Mr. MALCOLM. Which business unit?

Mr. BURTON. We are talking about the energy unit.

Mr. MALCOLM. The energy unit made about $1.7 billion.

Mr. BURTON. $1.7 billion?

Mr. MALCOLM. $1.7 billion in operating profit in 2000.

Mr. BURTON. Reliant, how much profit did you make in the year 2000?

Mr. STOUT. And you are asking for the business units, or are you asking about California?

Mr. BURTON. California.

Mr. MALCOLM. My answer did not——

Mr. BURTON. Well, you can give us California and then give us the total as well.

Mr. STOUT. I would respectfully request that you let us file that with you under confidentiality.

Mr. BURTON. Will you require a subpoena?

Mr. STOUT. No, sir.

Mr. BURTON. OK. Well, then, we would have that information.

Mr. MALCOLM. I would be happy to answer the question as you have now asked it. Our energy unit made about $1.7 billion, and I am speaking now about our energy services group, which is responsible for the unregulated and lightly regulated businesses. Marketing and trading is a part of that. And with respect to California's spot market activities, the percentage was about 5 percent of the $1.7 billion.

Mr. BURTON. Well, does that $1.7 billion include other States besides California?

Mr. MALCOLM. I have not expressed myself very well. The $1.7 billion relates to all the earnings of our energy services group, which includes products, pipelines, gathering facilities, refineries.

Mr. BURTON. That is inside and outside of California?

Mr. MALCOLM. Inside and outside of California.

Mr. BURTON. Do you have a breakdown that could give us the figures for California alone?

Mr. MALCOLM. I do not have them on the tip of my tongue.

Mr. BURTON. Can you get that for us as well?

Mr. MALCOLM. Yes.

Mr. BURTON. OK, we would like to have that.

Mr. Filner.

Mr. FILNER. Thank you, Mr. Chairman. Those are very good questions, similar to what I was going to ask, so they must have been good. Thank you. [Laughter.]

Now I have some not-so-good ones. First of all, Mr. John, thank you for your statement and your words. I want to take advantage of you here and do some case work that my other Congressmen will appreciate. Do you have staff with you?

Mr. JOHN. Yes, some.

Mr. FILNER. I mean, there is a constituent of mine named Jaime Salazar—if you would raise your hand, Jaime—who got a bill that was 500 times what it was the previous month, in which he had been out of town. He has tried to protest this, he has tried to call SDG&E, but has gotten no response.

He has pictures of the fact that his meter is behind a fence that is locked, and his rottweilers are there. He would know if the meter was read. Apparently the meter was not read, and yet he is getting bills of incredible amount, and they are threatening to turn off his electricity. Could you please make sure that Mr. Salazar's questions are taken care of.

Mr. JOHN. We will have somebody work with him this afternoon.

Mr. FILNER. Thank you very much.

Mr. Madden, for the record I have to say you are coming to California and to San Diego, which is the center of an incredible disaster, as you heard in the first panel. The economy of California, and maybe the Nation, is teetering. And you do not have anything to say. And just for the record, I found that very unsatisfactory. FERC is supposed to guard the interest of the consumer. Not only did you take no action back in December, when there was evidence of manipulation of the market—and in my opinion you caused most of the crisis that has been with us since—but you have nothing to say to us when you come here.

Mr. MADDEN. Congressman Filner, I have been with this committee for the past 3 days. I have——

Mr. FILNER. I have not.

Mr. MADDEN. Well, I wanted to cut my opening statement short simply to move on and get the questions answered.

Mr. FILNER. People in San Diego are in this audience. They are looking for some help. And we have nothing to say.

Mr. Malcolm and Mr. Stout, I am surprised that I guess Mr. Malcolm was ready to give some answers to the chairman. Mr. Stout claimed confidentiality. I am not sure why you have a different approach there. You were not very confidential in all these charts you got for us. Why can you not tell us the profits you made?

Mr. STOUT. Well, what I will do is give you an indication that I think means something to the——

Mr. FILNER. Can you tell me why you cannot tell us how much money did you make off California last year?

Mr. STOUT. The answer that I would like to give to that question is one that I think is in a context that means something in terms of what people pay for electricity. What I will tell you is that our net income in California this last year was less than 2 cents per kilowatt hour.

Mr. FILNER. And multiply that by millions of kilowatt hours. How much money is that?

Mr. STOUT. Well, that is the part that we would like to retain confidentiality on.

Mr. FILNER. Well, that is why we have so many problems with you all. You are whining about your costs and about all kinds of things, but then you will not tell us stuff we want to know about. Because everything is relative. I mean, do either of you, for example, have affiliates, subsidiaries that you buy your natural gas from?

Mr. STOUT. Yes, we do.

Mr. FILNER. Mr. Malcolm.

Mr. MALCOLM. Yes, we do.

Mr. FILNER. Mr. Stout.

Mr. STOUT. Yes, we do.

Mr. FILNER. So your increase in cost of natural gas, which you so proudly were telling us about, you are paying to yourself and they are making the money; right?

Mr. STOUT. Actually, our affiliates have to go out to the market and buy it. We are not producers.

Mr. FILNER. But you are buying from yourself. I mean, you are just playing games with these numbers.

Mr. STOUT. If I may answer the question.

Mr. FILNER. Your filings with SEC that you have to make public—I am not sure what is different then that you cannot tell us here—show incredible increases in profit over the last couple of years. You particularly have moved up on the Fortune 500, you know. You have gone from, I do not know, 117 to 55. So you are not doing too bad, with all this whining about the costs; right? Is that correct?

Mr. STOUT. Well, if I could, I would like to go back to your question about the gas purchases. It is absolutely true that we have an affiliate, but the affiliate is not a producer. They do have to purchase from the open market. We simply use that affiliate because of their gas brokering skills. So it is just an expediency measure, so that we have——

Mr. FILNER. And who are they buying from? I mean, do they have any relationship to the producers?

Mr. STOUT. Let me finish your first question, then I will come back to that last one.

You also asked a question about our SEC filings. The filings that we have made at the SEC that a lot of people have quoted as saying we have had a 600 percent increase in profit, that is a fundamentally flawed analysis. And the reason is, is because the numbers they are quoting are not profit numbers, those are numbers called operating income. That is before you take out things like interest, depreciation, and taxes. So that is not the bottom line.

Second, the size of our company, when compared with 1999 earnings, we more than doubled the number of megawatts that we have in the market. Our company has grown significantly since 1999.

And finally, 1999 was a year that was exceptionally poor return for a generating company in California. In fact, our income dropped about 80 percent between 1998 and 1999. Simply stated, 1999 was an exceptionally good hydro year, and that depressed the earnings. So anytime you draw an analysis comparing 1999 to year 2000, you get extraordinary increases.

Mr. OSE. Mr. Stout——

Mr. STOUT. Yes, sir.

Mr. OSE [continuing]. The red light has come on. The gentleman's time has expired. I am going to recognize Mr. Horn for 5 minutes.

Mr. FILNER. I will be back.

Mr. HORN. Mr. Madden, you have been with us in a number of these hearings. And after the chairman left to go back to Washington, a number of things were said by the president of the California Public Utilities Commission.

OK, can you hear it now? Somehow, somewhere?

Mr. MADDEN. I can hear you now.

Mr. HORN. You were there during some of the testimony of President Lynch, the head of the California public utilities. And I just——

Mr. MADDEN. I was there for all of it.

Mr. HORN. Yeah. And I just wonder if you would like to make a few statements for the records as to whether she said was accurate or not. Because there was a lot of finger pointing at your agency, etc.

Mr. MADDEN. Congressman Horn, if you do not mind, since I believe we should stop the finger pointing and the rhetoric between and among the various participants, whether State commissions, Federal, the players, I would prefer not.

Other than to say I think this committee has learned a lot of things in terms of the policies of the CPUC, as well as the FERC. And with respect to long-term contracts, there were major restrictions put on the IOUs in terms of buying long or buying in short-term packages, and there was also questions in terms of how they determine what the reasonableness is, or they would then second-guess the purchases by the IOUs.

Mr. HORN. Thank you. I will give you, Mr. Ose, the rest of my time.

Mr. OSE. Thank the gentleman.

Mr. John, you are with Sempra, if I understand correctly.

Mr. JOHN. Yes, sir.

Mr. OSE. The question I have has to do with the Governor's proposal to buy the transmission grid. I know he has a memorandum of understanding with Edison to buy theirs. Are you engaged in discussions with the Governor's office or the Governor's representatives to acquire San Diego Gas & Electric's?

Mr. JOHN. Yes, we are in discussions with the Governor's office.

Mr. OSE. I mean, I keep coming back to try and to figure out how to increase supply or reduce demand. And I am trying to understand how buying transmission grid facilities increases supply or reduces demand. Could you sort of elucidate or illuminate this, if you will?

Mr. JOHN. Well, that is a good point. There are two issues here. One is the point you are making about supply and demand. And on the supply side, I know the State has taken a lot of criticism for not building a sufficient number of power plants over the past 10 to 12 years.

On the other hand, I think the record does show that over the past year or so a lot of those projects have been approved. The concern is that not enough new power will be online by 2000, and certainly not by the summer of 2001, likely not the summer of 2002.

Maybe 2003, but more likely 2004. The only remedy we see over the short term, to avoid—and I do not mean avoid—to mitigate outages is increased conservation.

And that is one of the reasons we said to the PUC last year that we recognize the difficulty the customers down here were having with the high rates, but that some action had to be taken to start increasing rates on a stair-step approach in order to get customers to conserve. And there was some conservation in San Diego last year.

Mr. OSE. So going back to my question, how does the——

Mr. JOHN. OK. The sale of the transmission assets is a separate issue. That is to deal with removing or mitigating, at least, the huge balancing account under-collections that have built up, which, absent offsetting those balancing account under-collections, will be passed on to the consumer.

Mr. OSE. Your point is that the function of the transaction is to basically recapitalize the balance sheets of the utilities?

Mr. JOHN. That is correct.

Mr. OSE. It has nothing to do with increasing supply or increasing demand or conservation.

Mr. JOHN. And I do not think the Governor has ever said that it did.

Mr. OSE. OK. I appreciate that clarification.

I am going to recognize Mrs. Davis for 5 minutes.

Ms. DAVIS. Thank you. I appreciate—if I can just fix my microphone. Great. Thank you.

Mr. OSE. We are going to—let us restart the clock on Susan here. There you go.

Ms. DAVIS. Thank you, Mr. Chairman. I was reaching out so much that I got my mic.

I appreciate your all being here as well. And I wanted to just go first, if I may, to Mr. Madden with FERC. And what you may have been—I believe you were at the hearing that we had at Washington when the California delegation met with Mr. Hebert. And at that particular hearing I asked him what authority he lacks—the Commission lacks to do their job. And I wonder if you could respond to that.

And if you also could, tell us about the authority that you feel you perhaps need to better define for everyone how to figure out what is a fair and reasonable rate. How do you determine what levels of profit are OK? Are there some levels of profit that you think are not OK? And also, do you believe that you have the full power to subpoena people and establish whether or not there was manipulation in the market, and whether or not those—whether you have looked at those documents and tapes?

We know that in one of the reports where you suggested that the rates were not just or reasonable, that you also recognized, and in fact, you had it investigated what was going on in the market. So that would be helpful, just to get a sense of that, if you could. The other—and then I have some other questions, as well.

Mr. MADDEN. There are a lot of questions just there. Let me see if I can start out. The Commission has a great deal of authority under the Federal Power Act, to remedy the type of actions that exist today. Now, in terms of refund authority, our authority is the earliest of 60 days after a complaint is filed, such as the one that San Diego filed in August, or the date the—60 days after the Commission order is noticed in the public register—Federal Register, rather.

In this particular case, we took the earliest one, SDG&E's filing of August 2nd, and established the refund date of October 2. So in terms of the remedies and the refunds—and so our refund authority does not go back beyond or before October 2nd.

In terms of the remedies under the Federal Power Act, I think, as they exist today we have the full authority. There may be one thing in the future, depending on whether or not RTOs get up and running—and we hope they are—and that is transmission siting does not occur, transmission is not built, that is something that Congress should look at in terms of giving the FERC authority, if a State or an RTO does not act within a certain period of time.

In terms of subpoena power, the Commission has the subpoena power built in under the Federal Power Act in I believe 309 and 307 of the act specifically. And, in fact, in the Williams/AES proceeding, they delegated to me the full range of subpoena power so I can, in that particular case, request any particular documents and they have to be brought to me.

One thing that is missing in this Williams case, and which was in the notice, is that, although the timeframe talked about the April-May period, the Commission directed me to look into the remaining part of 2000 and into 2001. And I can assure you I will be vigilant in looking into those dates and those actions.

In terms of manipulation, there are a number of informal investigations that staff is doing to look at questions of outages, look at questions of withholding, look at bidding patterns. Although, you know, there have been, at the same time, some more public documents, we, at the staff level, conduct the type of informal primarily investigations as we did in the Williams case. I believe that should cover it.

Ms. DAVIS. Are those all included in public documents that we have been able to acquire?

Mr. MADDEN. The preliminary investigations are confidential until they are brought to the Commission, and the Commission has to decide what it will release. Because in many instances the entities that we review, audit, and monitor ask for confidential treatment. And many ask why confidential treatment. Well, there is a lot of things out there, that if it were released to the public, may affect them from a competitive standpoint.

At the same time, my view is that in order to get the type of interaction and the information we need from the various entities, it is best, at various stages, to give them confidential treatment.

Ms. DAVIS. Thank you. If I could go on. I know I only have 5 minutes. OK. All right. If I could just turn to Mr. Malcolm and Mr. Stout for a second.

Could you please share with us what percent of market share you believe your company has in gas-fired generation in California.

Mr. STOUT. Well, for Reliant, it depends on how you want to measure the market. If you measure California, I believe our market share is around eight—I am sorry. If you measure the ISO grid, our share is about 8 percent. If you measure all of California, which picks up the munis and things like that, that market share drops to I believe around 5 percent, maybe 4 percent. And if you pick up the whole Western interconnection, which that is really the market, not just California, it drops down to probably less than 2 percent.

Mr. BURTON. Mr. Stout, I appreciate the brevity. Your time has expired. I am going to go to Mr. Hunter. Mr. Hunter for 5 minutes.

Mr. HUNTER. First, let me—since Mr. Hebert has been mentioned several times, and Mr. Madden, you are here representing the Commission. Mr. Hebert and I, as Mr. Filner depicted, have crossed swords on several occasions on this issue in terms of price, and what is unjust and unreasonable.

But he does have a right to be quoted accurately. And actually, he did not say that if the high price of energy hurt granny, let granny die. He said that he believed in speaking the truth, and if the truth hurt granny, let granny die. And he further added that he had talked that over with his grandmother several times, and she did not agree with that statement. But I just wanted to make sure he is quoted correctly. And obviously he has in the record here, because he testified right where you are at.

Mr. OSE. Record stands corrected.

Mr. HUNTER. Mr. Stout, you pointed out that Reliant has actually increased the amount of energy that they now provide to California. They have not shrunk their energy output in California; right?

Mr. STOUT. That is correct.

Mr. HUNTER. Last summer we were using in excess of 45,000 megawatts. And as you probably are aware, if you watched the discussion among State leaders, it was to the effect, wait till winter gets here and all the air conditioners are turned off, and we historically drop usage by about 30 percent. So supplies are very tight right now at 45,000 megawatts. When they go down to about 33,000 megawatts, then the price will come down.

Winter arrived. We went down to about 33,000 megawatts, and we were told by the energy suppliers doggone it, supplies are still tight. Now, my question to you is: Were there any natural disasters that destroyed some of the generating plants, or was there some other reason for the supply of this product, energy, to go down by 30 percent when prices were rising?

Because typically, when prices are up and you are making lots of money and there was a lot of opportunity, you might not see new generational capability coming online right away because it takes a long time to get this stuff permitted. But certainly it is highly unusual that, in the face of rising prices, supplies were constricted. What do you think happened here?

Mr. STOUT. The answer to that is there were actually two disasters that took place. One was natural, one was manmade. The natural disaster was the fact that the Northwest region's hydro battery was being drained. If you look in the——

Mr. HUNTER. Say again. The hydro——

Mr. STOUT. Hydro battery. And I use that word loosely.

Mr. HUNTER. Yeah.

Mr. STOUT. It is not really a battery. But there is a certain amount of energy that is stored in the hydro systems in the Pacific

Northwest. If you look at the amount of hydro you had in 1999, it was above average. If you look at the amount that you had in year 2000, by the numbers I have seen, it was about 25 percent below what it was in 1999, but only slightly below average.

The bad news is the forecast for this year looks like it is going to be about 60 percent of average, which is even worse. Now, that impacted the problem, because the people that generate power with hydro up in the Pacific Northwest, a lot of those people, I believe, were coming to California to buy energy, trying to save what little charge they had left in their hydro batteries because they will not get another chance to recharge that battery until next winter.

There was also a manmade disaster.

Mr. HUNTER. Just on that point, how much of our usage is hydro?

Mr. STOUT. I could not quote a specific percentage without checking my records, but I would be happy to get that information.

Mr. HUNTER. So you think some of it was hydro being reduced as a function of the drought?

Mr. STOUT. Less hydro being generated. But also hydro being saved so more gas-fired generation in California was being utilized. There was also——

Mr. HUNTER. You say hydro being saved?

Mr. STOUT. Correct.

Mr. HUNTER. What does that mean?

Mr. STOUT. The folks that have hydro are trying to make sure they have enough energy to get them through this coming summer. The hydro battery is not fully charged. As I indicated a second ago, it may only be at 60 percent charge going into this year. And if they use up too much of it now, they will run out big time later in the summer.

Mr. HUNTER. OK. Well, just an aside, I was up campaigning in Washington last summer. And the talk—and again, I do not want to just—you deal in facts, and we need to deal in facts. But the talk was that several of the hydro producers were pulling their stuff offline because they were anticipating higher profits.

So whereas I do not have any specifics on the hydro reduction that you have talked about—apparently you do not have too many specifics, either—there is at least the possibility that they were anticipating and looking forward to reaping some of the same higher prices that some of the gas-fired guys were receiving on the spot market.

Mr. STOUT. Well, there is two sides to that story. The first is——

Mr. HUNTER. Do you think there is any truth to that at all?

Mr. STOUT. It is very possible there may be. I do not have factual basis.

Mr. HUNTER. OK, well, I tell you what, let us leave hydro, because we have got a lot of stuff we have got to talk about. Let us leave hydro.

You said part of this is hydro. Do you think there was any reduction among the gas-fired users that was a function of a strategy that said if we got high prices when supply is constrained, let us keep the supplies constrained. Do you think there is any of that?

Mr. STOUT. I cannot speak for every producer, but certainly that was not the case for Reliant.

Mr. HUNTER. OK. But you think that may have happened with others?

Mr. STOUT. I have no idea. I am not saying it did.

Mr. HUNTER. Mr. Malcolm, when you produce those records of documentation for the——

Mr. OSE. Mr. Hunter, the gentleman's time has expired.

Mr. HUNTER. Can I just finish my sentence, and I will be done with that question.

Mr. OSE. Finish your question. We will hold the thought on the answer.

Mr. HUNTER. OK. When you produce those documents for Chairman Burton, could you make sure you include any internal memos with respect to the direction of shutting down your facilities?

Mr. STOUT. Be happy to.

Mr. HUNTER. Thank you, sir.

Mr. OSE. Recognize myself for 5 minutes. One of the questions I have, and I want to be very clear about this, is if I understand, Mr. John, your company is subject to both FERC and PUC oversight.

Mr. JOHN. No. San Diego Gas & Electric Co. and Southern California Gas Co. are both regulated by the CPUC. They are not regulated by the FERC.

Mr. OSE. OK. Mr. Malcolm, how about you? Are you subject to the PUC regulation?

Mr. MALCOLM. I do not think so; no.

Mr. OSE. Mr. Stout.

Mr. STOUT. I do not believe so.

Mr. OSE. Are you subject to FERC?

Mr. STOUT. Yes, sir.

Mr. OSE. Mr. Malcolm.

Mr. MALCOLM. Most assuredly.

Mr. OSE. OK. Mr. John, you have generating facilities here in the State for electricity?

Mr. JOHN. San Diego Gas & Electric divested their generating facilities as part of the electric restructuring process. We do own a 20 percent interest in a nuclear facility up the coast.

Mr. OSE. But you have no generating facilities besides them?

Mr. JOHN. That is correct.

Mr. OSE. OK. So you buy your power on the market?

Mr. JOHN. Yes.

Mr. OSE. You have to go in and buy it.

Mr. JOHN. And I know there was a lot of discussion this morning about last year. And we were obligated for a significant portion of the year 2000 to buy our power through the PX.

Mr. OSE. OK. Mr. Malcolm, I want to make sure I understand your business motto. And Mr. Stout, you also. As I understand, Williams—or in Mr. Stout's case, Reliant—you in effect take the place of the credit-worthy buyer, provide the seller of the natural gas or the electricity the assurance of being paid. And then, as the market works, you will deliver power to the high bidder, so to speak. Is that accurate?

Mr. MALCOLM. Generally speaking, yes.

Mr. OSE. Mr. Stout.

Mr. STOUT. Yes, sir.

Mr. OSE. OK. Mr. Malcolm, do you have any generating facilities that you own?

Mr. MALCOLM. We have generation facilities in Pennsylvania and in Four Corners.

Mr. OSE. OK. So you are down here South—or actually East. Not South from——

Mr. MALCOLM. We control a portfolio today of about 15,000 megawatts by virtue of what we call tolling agreements, where we partner with someone, like AES in the case of California. We partner with them. They own and operate the facility. We provide the natural gas to and market the power from those facilities.

Mr. OSE. They have agreed to sell you the generation at some price on a long-term contract?

Mr. MALCOLM. We effectively pay a tolling fee for them to generate the power for us.

Mr. OSE. Mr. Stout, do you own your generating facilities?

Mr. STOUT. Yes, sir, we own facilities in California, about 4,000 megawatts. Another 4,000 in what we call the Midatlantic States. Generation in Florida, the Midwest. There are quite a number of facilities in our portfolio.

Mr. OSE. One of the things that just continues to challenge my understanding is if the PUC does not allow you to forward contract beyond 24 hours, how do you run your facilities? Mr. Malcolm.

Mr. MALCOLM. Well, that does represent some concern and some difficulty. But we are working in the spot market. And there have thus far been buyers for that power.

Mr. OSE. Well, let me turn the question around on the input side. In terms of the inputs that you buy to run your plant, do you buy those on a 24, day-ahead market?

Mr. MALCOLM. We contract for natural gas supplies in a variety of ways in order to be——

Mr. OSE. You transit, basically?

Mr. MALCOLM. Yes. Yes. In order to meet our needs. There is a base load, and there is certainly also a piece that we utilize on a peak day.

Mr. OSE. So what percentage of your total load do you leave vulnerable to the spot market?

Mr. MALCOLM. I am sorry, I do not have that number.

Mr. OSE. Could you get that for us?

Mr. MALCOLM. Sure could.

Mr. OSE. And my point—and I am going to ask you, Mr. Stout, the same question. My point is I want to understand—you know, business takes their vulnerability down to some percentage on a spot market basis. Whereas, the structure we have in the State of California basically has it at 100 percent.

Now, Mr. Stout, in terms of your generating facilities on the input side, in order to control your costs, provide a cost effective product at the far end, do you forward contract for the raw material, if you will, to run your facilities?

Mr. STOUT. That is a good question. The answer is, if I have a forward sale, then I forward contract for the input supply. If I do not have a forward sale, I have to buy it on the spot market. Because otherwise I would be taking a speculative position in the market.

Mr. OSE. All right. So you tie your exposure to your contract?

Mr. STOUT. That is correct.

Mr. OSE. OK. Now, as I look at—I see my time is about up, but we are going to come back to this if we have time. In the Wall Street Journal, every single day a report on the price of natural gas that you can buy forward. And it goes out 3 or 4 years in some cases. And I go back historically and I look last—they also have the high-low for the past year. And the high-low for the past year indicates natural gas at $2.07 low versus $5 plus for a high. Now, seems to me that most businesses would contract a year ahead, if you will—time? Rules are rules. No, rules are rules.

Mr. HUNTER. I yield to Mr. Ose.

Mr. OSE. All right. My question is: If the opportunity that existed last spring to buy natural gas at $2 was available, why were the intrastate generating facilities, that are subject to the PUC, not allowed to buy that, just to take the uncertainty off the table?

Mr. STOUT. I guess I am a little confused by your question when you said the intrastate utilities subject to the PUC. Are you referring to the IOUs?

Mr. OSE. Yes. I am separating you out on this.

Mr. STOUT. OK.

Mr. OSE. I am just trying to get some sense of what happened. I mean, it seems like you would take a whole uncertainty out of the entire transaction.

Mr. STOUT. I would have to defer that question to someone from one of those utilities.

Mr. OSE. But Mr. John last year you had facilities that were generating capacity.

Mr. JOHN. No, sir.

Mr. OSE. You had sold them by then?

Mr. JOHN. Yes, sir.

Mr. OSE. All right.

Mr. JOHN. We sold those in—my recollection was in 1998.

Mr. OSE. It seems like an excellent way to——

Mr. JOHN. When prices of gas were very low and prices of electricity were very low.

Mr. OSE. But being able to buy a year ahead certainly seems like an excellent way, when you know what your base load is going to be.

Mr. JOHN. Yeah. But, I mean, on the gas side, though, because we also own Southern California Gas Co., the real spike in the gas price started in the fall—at least into California, started in the fall, my recollection is, of 2000. And it went nuts in December 2000, where a delivered price into California was $50 per million BTU, compared to a historical price maybe of $2.50 or $3.

Even today, although it is not $50 per million BTU, it is close to $15 per million BTU. And that is primarily the transportation rate, not the wellhead cost of the gas. It is the transportation cost in the secondary market from Texas and Oklahoma, to California.

Mr. OSE. I am going to have to ring the bell on myself here.

Mr. MADDEN. Mr. Chairman, I did not want to ring the bell, but let me help the record a little. San Diego Gas & Electric is jurisdictional to us, to the extent it is sales for resale and wholesale transmission.

Mr. BURTON. That is correct. I was sitting back there listening. I guess I will take my time now.

You said at the wellhead the price is still fairly low?

Mr. JOHN. Well, again, low—it is higher than historical.

Mr. BURTON. What is it at the wellhead?

Mr. JOHN. Probably today around $4 to $5 per million BTU.

Mr. BURTON. Why are the transportation costs so high?

Mr. JOHN. Because the cap was removed in the secondary market on an experimental basis by the FERC. And several companies—I think even we—supported it at that time. But it was on an experimental basis. And I think that there is a limited capacity coming into California right now on interstate pipeline capacity, and people are taking advantage of it.

Mr. BURTON. So what you are saying is that they need more pipeline capacity and probably more exploration?

Mr. JOHN. I do not know about the exploration so much, but we certainly do need additional pipeline capacity coming into the State. And I think the gentleman from Williams talked about one of their projects.

What we are trying to convince the Federal regulators of is to make sure that we are meshing the new interstate pipeline capacity with the intrastate capacity, so when the new interstate capacity comes in, we are able to use it for electric generation. Because that is where the real demand is today.

Mr. MALCOLM. If I might add, there is no question that there is more pipeline capacity needed, and there is more wellhead deliverability needed.

Mr. BURTON. So you need more exploration as well?

Mr. MALCOLM. Yeah, there is a perception on a peak day that there is not enough supply, and therefore we do need additional deliverability.

Mr. BURTON. As I understand it, there are areas of California where there is reservoirs of natural gas that could be tapped if they could get by, I guess, the environmental requirements for exploration. Is that correct?

Mr. JOHN. Our company is not a producer, so I cannot comment.

Mr. MALCOLM. I am not aware of what the reserves are in California.

Mr. BURTON. I would be happy to yield. Turn on your mic.

Mr. HUNTER. I understand there are untapped gas resources in California. But on that point, Mr. John, you folks have now constructed a 30 inch pipeline going into Mexico.

Mr. JOHN. We have a pipe that serves the Rosasito Power Plant. We also are planning to build—one of our affiliates is planning to build a pipeline in northern Mexico.

Mr. HUNTER. Well, now, so my question is—I understand that. If we are short on gas and that gas shortage is—and the inability of our present pipeline system to move that gas is a main driver. And, you know, Mr. Malcolm says that—or Mr. Stout, that they would sell all the electricity we wanted for 2 cents above the gas price per kilowatt hour, that is kind of astounding. And if you are moving gas—if you are preparing to move gas to Mexico, does that not compound the price problem we are going to have here in the United States?

Mr. JOHN. I am not sure I am following you, Congressman.

Mr. HUNTER. Well, you got a 30-inch pipeline going down to the border. We got a shortage of natural gas in California which has driven prices to 500 percent of what they were. Why are we going to be moving gas down to Mexico when this low supply and high demand in California is driving our electricity costs 500 percent? Why are we moving more of it out of State?

Mr. JOHN. Because several of the plants in northern Mexico, when they are built, will be able to provide electricity to southern California.

Mr. HUNTER. Well, do you not have—but right now you are moving natural gas right now into Mexico, are you not?

Mr. JOHN. Yes.

Mr. HUNTER. How much are you moving?

Mr. JOHN. I think it is probably around—this is subject to check, but probably 40 to 50 million cubic feet a day.

Mr. HUNTER. Well, now, I was told, when you guys told us earlier, that you were moving electricity back, so there was kind of a quid pro quo, gas to Mexico, electricity to the United States. There is almost no electricity coming back into the United States.

Mr. JOHN. I think there is a limited amount right now. But the point I was making is the new pipeline that we are proposing to build in northern Mexico is for brand new energy efficient power plants, and a significant amount of that power will come into the United States.

Mr. BURTON. Let me reclaim my time, Mr. Hunter.

Mr. HUNTER. Thank you, Mr. Burton.

Mr. BURTON. How many cubic feet of gas are you sending down there a day?

Mr. JOHN. Right now?

Mr. BURTON. Yeah.

Mr. JOHN. My recollection is it is around 40 to 50 million cubic feet a day.

Mr. BURTON. Why is it going down there if there is no power plant to use it?

Mr. JOHN. There is a power plant. And we are going to——

Mr. BURTON. And where does that electricity go?

Mr. JOHN. There is an existing power plant at Rosasito.

Mr. BURTON. Where does the electricity go from that power plant?

Mr. JOHN. Most of it is to serve northern Mexico.

Mr. BURTON. So what we are doing is we are supplying this amount of gas to Mexico to power their utility?

Mr. JOHN. Yes. And that agreement was struck several years ago before we had this crisis. And we—you know, we believe in honoring agreements.

Mr. BURTON. What about gas exploration here in California? I was told there is some reservoirs of gas here in California. Can anybody tell me why that is not being tapped? I mean, it seems to me that you would not have to have an intrastate problem with pipeline if you could get more gas within the State, and the pipes could be utilized right here.

Mr. JOHN. Again, we are not a producer, so I cannot comment on that.

Mr. BURTON. Well, we probably ought to look into that. What is this here? Yeah. Why are we building electric plants in Mexico?

Mr. JOHN. Because the Government of Mexico seems to be more willing to have power plants built there than they seem to be historically in the State of California.

Mr. BURTON. Oh, my God. The government of Mexico has less stringent requirements for building a power plant, so you are building them in Mexico?

Mr. JOHN. Well, I do not think they are less stringent.

Mr. BURTON. Well, then why are they being built there?

Mr. JOHN. I think it is an expedited permit process.

Mr. BURTON. So you can get through the bureaucracy faster?

Mr. JOHN. So far; yes.

Mr. BURTON. Now, if you could get through the bureaucracy faster in Sacramento and in California, you could build them here.

Mr. JOHN. And I think they are working on that. I mean, I think the——

Mr. BURTON. Well, how many plants are you building down in Mexico?

Mr. JOHN. We, personally?

Mr. BURTON. Well, yeah. I mean, I would just like to know how many plants are being——

Mr. JOHN. We, personally, we are looking at one plant right now in Mexico. Other suppliers are in the process of building plants in Mexico. Not our company.

Mr. BURTON. And those could be built in California?

Mr. JOHN. Perhaps. I cannot speak for other suppliers. I am just telling you, we are building the natural gas pipeline system to serve those power plants.

Mr. BURTON. And is all the electricity that is going to be produced going to be utilized here in California?

Mr. JOHN. Not all of it. I think some of it will.

Mr. BURTON. How much?

Mr. JOHN. I do not know the figure.

Mr. BURTON. Well, wait a minute. It is your plant.

Mr. JOHN. One of the plants that are being proposed——

Mr. BURTON. Well, let us just talk about your plant. Your plant that you are building in Mexico, that is using American or Californian gas, is that plant going to be used——

Mr. JOHN. It is going to be a merchant power plant, and it depends who wants to take power from the power plant.

Mr. BURTON. So you are going to sell to Mexico as well as to the United States and to California?

Mr. JOHN. Possibly; yes.

Mr. BURTON. I see. With the power shortage here in California, when that plant comes online, if you still have that problem, you will still be bifurcating the power, giving part to Mexico and part here; right?

Mr. JOHN. Well, hopefully by the time our plant is online, which is probably going to be in the 2004 timeframe, enough additional supply would have come online in California that there will be enough reserve capacity, we will not have to worry about that.

Mr. BURTON. Mr. Filner.

Mr. FILNER. Thank you, Mr. Chairman. Welcome to California. [Laughter.]

I want to talk a little bit or try to get some understanding of what has been called market power. Regardless of all the stuff that you can or cannot tell us, the facts of the matter, are that California paid about $7 billion for electricity in 1999, and it is projected we could pay as much as $70 billion this year. That is some tenfold increase that has no relationship to anything you have told us about the cost of natural gas or regulation or anything. I mean, that has gone into your pockets and the other members of the cartel.

But how does that occur? Mr. Malcolm, in your statement you said you transport 17 percent of the Nation's consumption of natural gas.

Mr. MALCOLM. Yes, sir.

Mr. FILNER. What percentage coming into California do you control?

Mr. MALCOLM. The pipeline that we have coming into California is Kern River. And I think the capacity that Kern River controls versus all of the pipeline capacity coming to the State is fairly small. And I think, importantly, Williams does not control the capacity. Its customers, its end use customers——

Mr. FILNER. You transport 17 percent of the Nation's natural gas?

Mr. MALCOLM. We do, throughout the country.

Mr. FILNER. That is a pretty high percentage. And you have 4,000 megawatts, you said, basically of the gas-fired capacity in California?

Mr. MALCOLM. Yes, sir.

Mr. FILNER. I mean, you were asked the question, both of you, about percentage of the market, and you gave us some 8 percents, 4 percents, 2 percents. I have been told by people in the industry and the economists that the best way to measure market power is the number of megawatts that really determines the price. That is, there is a baseline use of, I do not know, 20,000 megawatts. And when you start getting demand above that, that is where control of the market comes in.

So that is where the 17,000 gas-fired megawatts come in. So if you have 4,000—each of you actually has about 4,000, as I understand it—it looks to me, of the ability to control the market in terms of prices, you have 25 percent of the market. Now, is that a good or bad way to look at it?

Mr. STOUT. Well, if I can respond to that. One of the things that we do in order to try and manage risk, is we try to sell off forward as much of that 4,000 megawatts as we can, so that we have some price certainty in our financial forecast. While I answered the question based on the number of megawatts that we had, when you take a look at how much we sold forward, who now someone else owns and controls, our market share is cut by more than half. So it is considerably less than that.

Mr. FILNER. Well, who has that stuff?

Mr. STOUT. There are at least 20 or 30 different market participants who have each bought portions of our generation portfolio, who now market that in the Western interconnection.

To get back, though, to another comment you made, Congressman Filner, about the $70 billion forecast, that is a very questionable forecast. I think that——

Mr. FILNER. What is your forecast?

Mr. STOUT. Well, my forecast I have not done. But I can tell you, from asking questions——

Mr. FILNER. We are paying $2 billion a month now, right now. So, just make that one. That is $25 billion. Is that closer to what you think?

Mr. STOUT. That may be. That is—if you look at what you pay——

Mr. FILNER. All right. So compare that with $7 billion, then.

Mr. STOUT. If I may finish the answer. If you look at what you paid in year 2000, you paid $27 billion, it is very possible that the prices could be very similar to what they were because of the increase in natural gas prices. Counter-affecting that, though there have been a number of forward contracts that have been entered into, which the Governor has publicly announced, which should help to mitigate some of that price exposure. I do not believe that that $70 billion estimate takes into account all those forward contracts that the Governor has put in place.

Mr. FILNER. But it is an incredible increase, and somebody is making that money. And that cannot be accounted for by anything else except profit. I mean, that is where it is going. This is America. You are allowed to make a profit. But let us understand what is going on here.

Mr. STOUT. If I may respond to that, sir——

Mr. FILNER. I want to ask Mr. Madden. Your name fell down, so I forgot your name. These folks who sell into the California market at a wholesale price, did they have to get authority to do that from FERC?

Mr. MADDEN. Are you talking, now, gas or electricity?

Mr. FILNER. Electricity.

Mr. MADDEN. They have market-based rates and they have——

Mr. FILNER. Is that based on an approval from FERC?

Mr. MADDEN. They received approval from the FERC.

Mr. FILNER. All right, now, correct me if I am wrong, any of the three of you. When they asked for that authority, one of your criteria is market power. They said in those filings, as I read them, that there was something like 60,000 megawatts of capacity in California. And therefore, their few thousand was a real low percentage of that, and therefore they had no market power. Do those figures sound like what they had filed to you?

Mr. MADDEN. I do not recall, Congressman.

Mr. FILNER. Do either of you recall what you estimated as the California capacity was?

Mr. STOUT. I do not recall.

Mr. MALCOLM. I do not recall.

Mr. FILNER. You guys got to prepare like I do here. All right, read your filings. You said around 60,000 was available, which is, of course, way above what the actual capacity is. So therefore, your estimates of market power were way below what the actual fact is. And if you take a true estimate that economists have told me—that is, the percentage of the market that really determines the price—

it is inescapable to me that you have market power. Notwithstanding what you said about forward contracts, etc.

And it seems to me, Mr. Madden, that your approval of their market-based rates was based on a certain estimate of market power, and I think we can prove that it is much greater. Would that not lead you to reconsider their authority to sell at market-based rates?

Mr. MADDEN. We have the authority to look at our market-based rates that we have issued under Section 206 of the act.

Mr. FILNER. So you can do that right today?

Mr. MADDEN. We have the authority to initiate an investigation.

Mr. FILNER. All right. And we would formally request that at some point; OK?

Mr. MADDEN. In the November order we looked into the particular rates being charged, and those were subsequently addressed in the December 15th order by the Commission. We are looking at the rates now.

Mr. FILNER. And in the December 15th order, as I said, you found all kinds of problems and have not acted on any of them. And I will ask you guys, do those figures about market power sound reasonable or not to you?

Mr. STOUT. Well, let me respond to your 60,000 megawatt number. When you examine market power, you do not draw a boundary at the State border. You examine the market that you are competing against. I compete against generators in Arizona, Nevada, and all around the Western interconnection. It is very possible that in trying to define the range of market competition, that it included more than just California. And so you may, in fact, have had more megawatts in that market power analysis than——

Mr. FILNER. So, but your 4,000—the 4,000 figure is also only California, so you may have more megawatts elsewhere; right? Too, right?

Mr. STOUT. That is correct.

Mr. FILNER. So if you will give me all those figures, I will tell you what your market share is. And I bet you you have market power.

Mr. STOUT. Well, we respectfully disagree with your conclusion with regard to market power, but we will be happy to furnish you with the details of other generating units. I can quickly summarize, if you would like.

We actually brought on a generating unit this last year. No one mentions that. But it was this 500 megawatt unit. We own half of it, Sempra Energy owns the other half. It is located just outside Las Vegas, but it is not connected to the Nevada power system, or at least it was not last summer. It was actually connected to the California grid, and was contributing to help keep the problems in California as minimal as possible, as well as keep the price down.

We are also bringing on another 500 megawatt project this summer in the Western interconnection.

Mr. FILNER. I appreciate your attempts to keep our prices down. I have not seen that in anything that you have told us today.

Mr. STOUT. Well, you just indicated that the more competition you have, the more effective the market works, and I agree with you on that. Bringing on more generation increases the competition in the market.

Mr. FILNER. Well, hold it.

Mr. HUNTER. I just want him to be allowed to answer the question. The second 500 megawatts?

Mr. STOUT. Arizona.

Mr. BURTON. Who is next? Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. I want to go back to Mr. Seetin's remarks this morning. He indicated very clearly today that he thought the market structure in California was seriously flawed. And interestingly enough, when he was asked to testify before the legislature in 1996, he made the same observation. And in fact, much to everybody's chagrin, his prognostications appear to have come to fruition.

The question that I am trying to deal with is, as we go from here forward, how do we solve this problem. And we can sit up here and argue about everything.

But I just want to make sure I understand. I heard you very clearly say we need additional gas transmission lines into the State. Is that accurate?

Mr. MALCOLM. Yes.

Mr. OSE. OK. I believe I heard you say that the market structure that exists in—I think Pennsylvania was the citation you made, where the long-term forward contracting was allowed, and direct access was allowed, is a far more preferable model than the current one we have in this State; is that accurate?

Mr. MALCOLM. That is not part of my filing.

Mr. OSE. Mr. Stout.

Mr. STOUT. Well, the comment was made. And let me clarify what really goes on in PJM. They have a spot market in PJM, as well. The difference is that the spot market only accounts for 15 percent of the energy supply. The rest of it is either utility-owned generation, which is about 50 percent. The remainder, I think that is about 35 percent or so, is forward contracting. So what they have is PJM is a portfolio of supply. That is what you did not have in California. So when you had—and, in fact, you can have thousand dollar megawatt hour prices in PJM, but that only applies to a portion of the energy.

California, if you had thousand dollar prices, under the market design which you had this last summer, you had that applied to 45,000 megawatts.

Mr. OSE. So your point, then, was that the construction of the now-defunct PX—but I guess now the ISO is doing it. The construction by which the market-clearing price that you showed up there, where the lines crossed as opposed to where the bid was, is flawed because it pays the——

Mr. STOUT. No, absolutely not.

Mr. OSE [continuing]. Because it pays the top guy's price to everybody in the market.

Mr. STOUT. No. Let me be perfectly clear on that. The problem was not in the market-clearing price concept. The problem was in the fact that California had to buy everything from that one market, rather than having a portfolio of markets to buy their energy from. The PJM clears at a clearing price in their spot market, just like California did.

Mr. OSE. OK. Then it is the constriction that allows the different tranches of demand, the base versus the peak, to all be priced at one price, instead of a variety of prices?

Mr. STOUT. That is right on target.

Mr. OSE. OK. Now, the other question that I have, and this is news to me, and I appreciate Mr. Hunter and Mr. Burton and Mr. Filner and Ms. Davis bringing it to our attention. Did I understand correctly that we are shipping natural gas to Mexico right now?

Mr. JOHN. Yes. And so are other pipeline companies in Texas for power plants.

Mr. OSE. We are shipping natural gas out of California into Mexico?

Mr. JOHN. Uh-huh.

Mr. OSE. For what purpose?

Mr. JOHN. To generate electricity in northern Mexico.

Mr. OSE. For whom?

Mr. JOHN. I do not know the exact figures, but I know some of the power comes back into California, some of it is actually used in northern Mexico. This is part of the North American Energy Policy that President Bush has been espousing.

Mr. OSE. Well, I appreciate you bringing that up. I think I have found something that I can drop a note to President Bush about. And I am sure that he can speak with President Fox about it. But I am just amazed. I mean, how many—Mr. Hunter, if you will, how many—some of your constituents have been cutoff, if I understand correctly, from access to natural gas.

Mr. JOHN. And so have some—and so has this power plant in Mexico, but it has been done on a pro rata curtailment basis.

Mr. BURTON. Would the gentleman yield to me just a second?

Mr. OSE. I would yield; yes.

Mr. BURTON. I would like to know what rate per cubic foot, or however you charge for the gas, what rate are you getting in Mexico? Are you getting more there or same amount of money?

Mr. JOHN. Same. I mean, it is basically a tariff rate that is approved by the California Public Utilities Commission.

Mr. BURTON. It is a rate that is approved by the Public Utilities Commission here in California?

Mr. JOHN. Right.

Mr. BURTON. That you sell to Mexico?

Mr. JOHN. Uh-huh.

Mr. BURTON. So you are getting the same amount of money?

Mr. JOHN. Uh-huh.

Mr. BURTON. But you have less what? Restrictions?

Mr. JOHN. The restrictions I was referring to, Congressman, is the restrictions on construction of new power plants.

Mr. BURTON. OK. Thank you for yielding.

Mr. OSE. Did the PUC approve the transfer of this natural gas to Mexico?

Mr. JOHN. Yes.

Mr. OSE. Did FERC?

Mr. MADDEN. The export-import of gas is approved by the Department of Energy. The siting of the facility is the Federal Energy

Regulatory Commission. The CPUC, because of the Hinshaw status of this facility, approved the tariff. We did not do that.

Mr. OSE. I can flat guarantee you, Mr. Chairman, we are going to look into this. And I yield back.

Mr. BURTON. If the gentleman would yield his time.

Mr. OSE. I yield my time.

Mr. BURTON. I think that Mexico has substantial gas reserves. In fact, they have a lot of oil reserves, too, down there. Is the reason that they are importing gas from us because they do not have the pipeline capacity down there?

Mr. JOHN. That is correct. I mean, there are very few—to the best of my knowledge, there are very few natural gas reserves in northern Mexico. Most of the reserves are in the southern part of the country.

Mr. BURTON. Well, but that is—but we are sending our gas down there while Americans are suffering, at a time when they really need the generation; right?

Mr. JOHN. But I think you have to take a longer-term look at this issue. I do not think it makes——

Mr. BURTON. Well, you tell that to somebody whose lights go out. I was having dinner the other night, and the lights went out in the middle of dinner.

Mr. JOHN. And all I am saying to you, Congressman, is when we have to curtail in southern California, we also curtail in northern Mexico. So they are feeling the same pain. It is not—they are not getting favoritism.

Mr. BURTON. Well, that is very nice, except we do not represent Mexico, we represent America.

Who is next?

Ms. DAVIS. Thank you. Thank you. While we are on natural gas—and I appreciate, Mr. John, what you are sharing with us, because sometimes it is hard to get information like that directly. I am aware that there was a Rand Corp. report in I guess December or January that said that California was being charged something in the neighborhood of about 60 times the rate of other States, other places in the country. Is that correct, that we were paying——

Mr. JOHN. I think what they were referring to, Congresswoman, is in the month of December 2000 the price of gas to California was about $50 per million BTU. And you would compare that to probably somewhere around $5 or $6 per million BTU in other parts of the country. So that we were paying basically, at that point in time, about 10 times more than other States.

Ms. DAVIS. And why was that?

Mr. JOHN. Because of the cost of transportation between the Southwest and the California border.

Ms. DAVIS. And then, so if there was natural gas, what about in Mexico, then? What were they being charged at that time?

Mr. JOHN. I do not know that.

Ms. DAVIS. But is it possible that we were being charged a lot more here in San Diego than in Mexico?

Mr. JOHN. The transportation rate that we were charging to the power plant in Mexicali, as I said, was a PUC approved rate, not a FERC approved rate.

Ms. DAVIS. So the ones that were higher in southern California were FERC approved rates?

Mr. JOHN. They were rates in the secondary market. The maximum rates that FERC approves are tariffed rates in the primary market. But as I said earlier, FERC allowed, on an experimental basis, the caps to be lifted in the secondary market.

Mr. MADDEN. Congressman, if I may, the prices did hit $50, even $60 at Topock, CA, for about 2 or 3 days in California. If you look at the San Juan basin at that time, it was about $10 to $15. Other areas of the country with constraint points, like New York City, had about $50.

In terms of the gas itself, the Federal Energy Regulatory Commission has very little jurisdiction over the amount of gas because of the decontrol. Essentially it is with respect to gas that is in interstate, intrastate, or in LDC ships, or it is an affiliated. And even then it is restricted. If it comes in from Canada, we do not have the authority, and if it is their own production, we do not have the authority.

We are looking into that matter right now. And he raised the case in terms of the transmission. We do have jurisdiction over the transmission. No one can charge more than the J&R rate on the pipeline. The pipeline cannot get that.

Mr. John is talking about the secondary market, where we relaxed the price and allowed people to—people, not the pipeline shippers, and they include everyone, including Mr. John's company, everyone to charge the value of the transportation.

We have done an analysis of it, and it has shown that in the secondary market—and we required it to go on the board—in the secondary market, very few volumes went into the secondary market, and the prices were at or above the J&R rate that is approved in the primary market. So there is transparency there.

At the same time, we are looking into whether or not certain entities manipulated the gas prices, because they were a market power, to raise the prices at those points in California.

Ms. DAVIS. When will that information be available to the public?

Mr. MADDEN. We, in the first instance, have set a matter for hearing last week, and we ordered the judge to report back to us in 60 days on that matter.

Ms. DAVIS. Thank you. If I may, Mr. Chairman, just for a moment, to go back to the market control that we were talking about. And I think, Mr. Stout, you had answered the question about the percentage that you control. I do not—Mr. Malcolm, did—what percentage?

Mr. MALCOLM. Less than 10 percent on a peak day.

Ms. DAVIS. Less than 10 percent. Because when the ISO reviewed the records and did a profile, it is my understanding that there were about five companies that they looked at, and those five companies controlled about 98 percent of the market. Was Williams part of that, do you think, in that survey? Would they be——

Mr. MALCOLM. I do not think so. I can assure you it would be my view that Williams is not part of any five-company group that controls 98 percent of the capacity.

Mr. STOUT. I would agree wholeheartedly. There is no way the five generators, who I think together have about 16,000 megawatts, that, by no stretch of the imagination, is 98 percent of the market.

Ms. DAVIS. Well, we might go back and look at that.

Mr. FILNER. Would you yield?

Ms. DAVIS. Yield? Sure.

Mr. FILNER. It was not 98 percent of the market, it was 98 percent of all the bids that five companies submitted, and you two are amongst those five, showed control of the market. The bids reflected market power, is what the ISO has alleged.

Mr. STOUT. Well, I would very much appreciate you sharing that particular document with me. I am not aware of that document.

Mr. MALCOLM. Nor am I.

Mr. FILNER. If that were true, Mr. Madden, if ISO has alleged it correctly, would their authority for market-based rates be revoked?

Mr. MADDEN. I think the facts upon which you are relying are not based in anything that I am aware of. Because if you—their share in total—you have to look at what PG&E has, you have to look at what So Cal Edison has, you have to look at what San Diego has.

Mr. FILNER. You understand ISO knows this better than I do.

Mr. MADDEN. Well, if you look at those alone, they are about 60 percent of the market. And then you have to look at all the other sellers in——

Mr. FILNER. The issue was not what percent of the market. What the issue was, as I understand it, the bidding pattern and the ability to get the price that they bid reflected market power. And that is their statement, not mine. And if that is true, now I am just asking you if it was true, would their authority to sell at market-based rates be revoked?

Mr. MADDEN. We would have a number of equitable remedies to do with respect to that, including revocation of market-based rates.

Mr. FILNER. Thank you.

Mr. BURTON. Mr. Horn.

Mr. HORN. I yield my time to Mr. Ose.

Mr. BURTON. Mr. Ose.

Mr. OSE. Thank you, Mr. Horn. I want to go back to the Pennsylvania—PJM, Pennsylvania-Jersey Market situation. I just want to make sure I understand that. Mr. Stout, based on your comments, I am inclined to believe that people in the energy business in that marketplace calculate their base, hedge their exposures for a vast, vast percentage of the entire load that they have to provide. Am I correct?

Mr. STOUT. On average, that is correct. On specific company basis, that may not be correct.

Mr. OSE. OK. From your experience relative to the average company basis, do they hedge 95 percent on long-term?

Mr. STOUT. The actual percentage is 85 percent, as published in the PJM annual report last year.

Mr. OSE. OK. Now, when you look in the Wall Street Journal on a daily basis, there is a chart in there that says "PJM," "Four Corners," "California-Oregon Border," etc. And it shows prices for firm and non-firm, peak and off-peak power, electricity. I think the actual compilation of data is either 3 or 4 days, the day immediately past, and the preceding 2 or 3 days.

And it always seems to me, when I look in or at that chart, that the price at COB is far higher than say at Mead or Four Corners or PJM. And I have never—why is that? Is that a recent development?

Mr. STOUT. I would have to say that is more of a recent development. And the primary reason is, if you look at what fuel is on the margin in PJM this time of year, it is not natural gas, it is typically coal. They are down low enough in load that they are able to minimize their use of natural gas as the marginal fuel.

But the problem you have in the West right now is, because of the low hydro battery I mentioned earlier, gas is on the margin. Gas prices are up, and the cost of generating with natural gas is causing those higher prices there.

Mr. OSE. Would you agree with that, Mr. Malcolm?

Mr. MALCOLM. Yes.

Mr. OSE. Is there a premium that is attached in the market to power being sold into California? In other words, is there a risk premium that is attached to that power?

Mr. MALCOLM. There is certainly a credit premium——

Mr. OSE. OK, a credit premium.

Mr. MALCOLM [continuing]. Assigned to sales coming to California. And for good reason.

Mr. STOUT. But there is also an opposite effect. And I guess I would comment that if I looked at prices in California for power for next summer, compared them with prices around California, California is actually lower. The reason that occurs is because California has put in place, through their ISO, some rules that allow them to confiscate exported power whenever California runs short.

That puts anyone who is in California, who is selling power in the market, at risk for firm contracts that they enter into with anyone in Nevada or Arizona. And as a result, you have to add an additional risk premium when you sell power to someone outside of California, because of the risk that California will confiscate that power.

Mr. OSE. Because of the interruptible nature?

Mr. STOUT. It is not interruptible. We are doing firm contracts, but their rules say that if they need the power in California, they can interrupt it and keep the power in California.

Mr. BURTON. Would the gentleman yield real briefly?

Mr. OSE. It is Mr. Horn's, but I would be happy to.

Mr. BURTON. Mr. Horn, would you—OK. We will get you some more time, if you would yield to me a little bit.

Mr. HORN. That will be fine.

Mr. BURTON. You are talking about the electricity; right?

Mr. STOUT. That is right.

Mr. BURTON. What about gas? Can they confiscate gas, too?

Mr. STOUT. I am not aware of anything in that regard.

Mr. BURTON. I was just wondering about the gas that is going to Mexico.

Mr. STOUT. Well, this is in the California ISO rules.

Mr. BURTON. That is a power generating source. I mean——

Mr. MADDEN. Mr. Chairman, they cannot confiscate interstate gas supplies.

Mr. BURTON. What is the difference between that and the electricity he was talking about?

Mr. MADDEN. Well, I assume what he is talking about, there is a tariff provision in the ISO that says in emergency conditions they will require power that is sold into other areas come back to California.

Mr. BURTON. Well, I understand that. But you cannot generate power without gas down here, and it is going to Mexico, so what is the difference? You cutoff generation.

Mr. MADDEN. The difference is that there is a tariff, and the tariff on file is—all I can think of, there is no confiscation of interstate natural gas supplies.

Mr. BURTON. Well, we ought to look into that. If it applies to electricity, why would it not apply to gas which produces the electricity?

Mr. OSE. I want to examine this particular issue. And I appreciate the information on the PJM market. Are there turbines or generating capacity in California that is offline for lack of natural gas, to anybody's knowledge?

Mr. JOHN. Not to my knowledge.

Mr. STOUT. Not to mine.

Mr. MALCOLM. Not to mine.

Mr. JOHN. And that is why I think this issue with Mexico is a red herring.

Mr. OSE. Well, I think it is a fair question. I mean, I think your point is a fair point to make.

Mr. MADDEN. Mr. Chairman, there is about 7.1 BCF of interstate gas supplies, gas supplies coming into the California market every day. Every single day. There are constraint points in various parts of southern California where they cannot take away the gas supplies that come into California.

Mr. OSE. OK.

Mr. MADDEN. So, and that is something that I believe the CEC now is looking with the other utilities in terms of identifying what infrastructure in the State needs to be added in order to take more gas supplies away from the pipelines.

Mr. OSE. We are still going to look at it. But I think your point is fairly made. So I appreciate that.

Mr. JOHN. And the only thing I would add to what Mr. Madden just said is, one of the filings we recently made to the FERC was to take a regional approach, looking at all the new interstate pipeline capacity coming into California, and make sure it meshes with the intrastate capacity. And I know they are looking at that.

Mr. STOUT. Congressman, if I could add a very important point to that. It is very easy to take the attitude, let us protect our natural resources. Let us keep it in California. Let us not let it go to Mexico. But let me remind you, California is also critically dependent on power coming from Canada.

Mr. BURTON. If the gentleman would yield real quickly, let me just say that Canada does not have a power problem, do they, right now?

Mr. STOUT. Not that I am aware of.

Mr. BURTON. Well, that is the difference. You are talking about eggs and apples.

Mr. Hunter.

Mr. HUNTER. Thank you, Mr. Burton. Mr. John, let us go back to this issue. I am glad I brought it up with respect to Mexico.

You testified about a 500 percent increase in the cost of natural gas, and the fact that is the driver on electricity. In fact, Mr. Malcolm said that you had a standing offer, anybody wants to buy electricity from us, 2 cents a kilowatt hour, which is extremely low, plus the price of natural gas.

Then we said well, why is natural gas so expensive?

And one of you said well, at the wellhead it is still relatively inexpensive. But because of the constraints on our pipelines coming into California, it has gone up 400 or 500 percent.

Mr. JOHN. From the Southwest.

Mr. HUNTER. Then we said but some of it is going out to Mexico.

And you then said, in answer to a question, we got plenty. And what is sent to Mexico does not bother our supply at all. And no plant is short because of the amount going to Mexico.

Mr. JOHN. That was in response to a question from Congressman Ose.

Mr. HUNTER. OK, now, reconcile—well, taken holistically, now, reconcile those statements you made. There is no problem with supply, and so we should not worry about Mexico. And yet the problem with supply in California has driven the price up 500 percent.

Mr. JOHN. But it is not the supply, Congressman. It is the cost of the transportation.

Mr. HUNTER. Well, now, wait a second. But one of you testified it was not the physical cost of transportation, it was the fact that there was a shortage of transportation, and there is apparently a competition for the transportation; that is, for portions of the gas line. Right?

Mr. JOHN. On the interstate side. In the case of the gas that is going to Mexico, it is going through the existing distribution systems in California, and there has——

Mr. HUNTER. Well, but if you were not sending that gas to Mexico——

Mr. JOHN. Yes.

Mr. HUNTER [continuing]. Then you would not have to be—everything that goes to Mexico passes through California from another State; right? We are not generating much natural gas ourselves; right?

Mr. JOHN. The gas supply that is coming in from—that is serving Mexico?

Mr. HUNTER. Do we generate much natural gas from wells in California?

Mr. JOHN. We produce a fair amount, but not as much as you are getting from the Southwest.

Mr. HUNTER. OK. If you have got a supply of gas coming to California in the intake lines, we will call them, and you said because of a constriction in these intake lines we have—prices have gone up much more than they are at the wellhead, so that is a line problem you have got. Some of that capacity is being taken by the gas that comes into California, and then flows out in this 30-inch line into Mexico; right? Right?

Mr. JOHN. Go ahead.

Mr. HUNTER. Then why are you saying there is no relationship between the capacity in those lines? If you did not have the gas going into Mexico, presumably that volume of gas would not be a factor in the constriction of the lines coming into California, because you would not be trans-shipping it; is that right?

Mr. JOHN. I am still not following you.

Mr. HUNTER. OK. You got a pipeline coming into California bringing gas from other States; OK?

Mr. JOHN. I understand that.

Mr. HUNTER. Part of that gas is going through California and going into Mexico. OK? You stated, or one of the panelists stated that one reason the price of gas is going up is not because of what it costs at the wellhead, it is because of the constriction or the lack of availability of capacity in the lines coming into California.

If part of that capacity is taken, with natural gas that comes from other States, goes through California and goes out to Mexico, why would you not alleviate part of that problem and the attendant price increases if you did not have that volume of gas basically flowing through? If we were not also flowing through our neighbor's gas?

Mr. JOHN. But there are other pipelines that serve California, other than from the Southwest.

Mr. HUNTER. I understand that.

Mr. JOHN. There are pipelines from Canada, there are pipelines from the Rocky Mountain region.

Mr. HUNTER. We understand all that.

Mr. JOHN. So you cannot assume that all of the gas that is going into Mexico is coming from the Southwest.

Mr. HUNTER. No. But you can assume that it is relevant. Because, as you know, as we all know now, the, you know, 5 percent shortage on supply can mean a doubling of price.

You other gentlemen have any insights on this?

Mr. STOUT. I guess my comment would be there is a direct relationship between supply, demand, balance, and price. The more demand you put on a pipeline, the more likely it is that the cost of using that pipeline will rise. And I think that is the point you are alluding to.

Mr. HUNTER. Yeah.

Mr. JOHN. I know that is. All I am trying to say is, do not assume that all of the gas that is coming into Mexico——

Mr. HUNTER. We have not.

Mr. JOHN [continuing]. Is going from the Southwest.

Mr. HUNTER. No, we have not. But it may be relevant.

Mr. JOHN. Maybe.

Mr. MALCOLM. I think some of the points, some of the pipelines that bring gas into California are constrained. Others are not. And therefore, there may be some excess gas that could go to Mexico.

Mr. HUNTER. OK. Second question. If you have got a 500 percent increase in natural gas prices, does that make diesel more attractive? And do we have diesel generational capability we could turn on either in California, or in other States that moves electricity into California, if diesel remained relatively stable? Is diesel a good deal right now in terms of cost? Not air quality, but cost.

Mr. STOUT. Unfortunately I do not have any diesel generation, so I have not done that particular analysis. But there is a breakpoint where it will become economically efficient to do that. I just do not know exactly where that breakpoint is.

Mr. MALCOLM. I think for the most part it would be economic today.

Mr. HUNTER. You think it would be economically feasible now?

Mr. MALCOLM. Yes. Yes.

Mr. HUNTER. So if we had some relaxation on air standards, if we are in an emergency situation in the summertime, moving some diesel-fired electricity would be economically feasible?

Mr. MALCOLM. I think it would be. No question that every little bit would help.

Mr. HUNTER. Just a last question. Do you have more generational capability you could turn on right now, but for regulations, procedures, laws? If you were having to—if you wanted to save California in 60 days from what is going to happen in the summer, and you were told to get every piece of generational capability online, is there anything you would do that you are not doing now?

Mr. MALCOLM. We may be plagued with No_x restrictions at some point this summer, that could reduce the amount of megawatts that we have available.

Mr. HUNTER. That is when you have to stop because you put too much stuff in the air?

Mr. MALCOLM. That is right. That is right.

Mr. HUNTER. OK. Mr. Stout.

Mr. STOUT. That is absolutely correct for me as well.

Mr. HUNTER. OK. OK, thank you, Mr. Chairman.

Mr. BURTON. Thank you. I guess it comes back to me. I think we have covered that.

Mr. MALCOLM. Mr. Chairman, could I have 15 seconds——

Mr. BURTON. Sure.

Mr. MALCOLM [continuing]. On the show cause order, which we sort of went through very quickly at the beginning.

Mr. BURTON. Sure. Sure.

Mr. MALCOLM. I would just want to say that we feel very strongly that a full and fair investigation will yield the conclusion that we did no wrongdoing, that we did not break any rules. And to the extent that information is provided to the committee, we want to have the opportunity to present our side of that story. The show cause order is very one-sided and very biased.

Mr. BURTON. We will be very happy to. First thing we need is, we need to get the information we have requested from you and FERC. We get all that information, and we will have our legal staff and everybody take a look at it. And then if you would like to come to Washington and appear and make a case, we will be happy to talk to you. We are not in the decisionmaking process in that area. We are looking at legislative remedies to help with the problem. But if you want to do that, we could probably talk to FERC and you and, from a congressional level, take a hard look at it.

Mr. MALCOLM. Thank you.

Mr. BURTON. To Reliant and Williams, what is the difference between the profits made by the independent generators compared with the municipal and Federal power sellers such as the Los Angeles Department of Water and Power and Bonneville Power Administration? Did you understand the question?

Mr. MALCOLM. You asked what the difference is?

Mr. BURTON. What is the difference between the profits made by the independent generators compared with the municipal and Federal power sellers such as the Los Angeles Department of Water and Power and Bonneville Power Administration?

Mr. STOUT. Mr. Chairman, I would love to know the answer to that question, myself. But, honestly, there is no way for me to have access to their profit numbers.

Mr. BURTON. So we would have to get information from you and them?

Mr. STOUT. That is correct.

Mr. BURTON. And then compare them. Did you hear that? OK, we need to get that. We will request your information and we will get that. I am way past that already. Do not worry about it. I am probably up to about 1,100.

To Reliant, Williams, or Sempra, the utilities—I was not suggesting I was going to have to subpoena these things. I think they are going to volunteer those information, are you not?

Mr. MALCOLM. That is correct.

Mr. BURTON. Thank you. But if necessary, we will do what we have to do.

The utilities, in order to receive the benefit of the Cal ISO price cap, often scheduled their power purchase in the spot market instead of the PX. How did this affect the price of electricity last year? You want me to repeat that?

Mr. STOUT. Well, I guess my comment on that is that they were almost forced to buy all of theirs in the spot market. So that question sounds a little strange to me.

Mr. JOHN. That is my understanding. If that is the question, the utilities were required to buy out of the PX, and the PX was basically the spot market at that time.

Mr. MALCOLM. And so, since they were not able to take advantage of the forward market, long-term sales, then it had the impact of increasing the cost of power.

Mr. BURTON. We will submit these questions to you a little more succinctly in writing. And if you could respond to those, we would appreciate that.

Why did generators continue to make large profits as the price caps were lowered last summer? Any one of you.

Mr. STOUT. Well, I am not sure that the statement is accurate. I do not personally know——

Mr. BURTON. Did you not make large profits last summer.

Mr. STOUT. We made profits last summer. I do not know the relationship between the profits that were being made versus the price cap. I have never gone back and looked at that.

Mr. BURTON. Well, as the price caps were going down——

Mr. STOUT. Part of the problem—part of the reason that generators in California probably made more money when price caps were lowered is because people outside of California were less likely to sell into California, which increased the volume that generators in California sold. Our profits are directly related to the amount we sell. So as volume goes up, the order of profits should go up as well.

Mr. BURTON. So you are saying your profits were outside the State?

Mr. STOUT. No. What I am saying is, people from outside the State, when given a choice between selling into a price capped market, like California, and other markets which were not price capped, probably chose to keep their power and sell it somewhere else.

Mr. BURTON. I can understand that. That makes sense. But your profit margin continued to rise, did it not?

Mr. STOUT. Once again, I do not know that is an accurate statement, because I do not know how our profit margins compared month by month as the price cap changed. I have never looked at that.

Mr. BURTON. Can we get that information?

Mr. STOUT. I am not sure if we have that, but I will take a look and see.

Mr. BURTON. Well, it should be a simple accounting—you should have records, I would think, showing your profit margin month by month during those times.

Mr. STOUT. Well, I agree to go back and check and see what we can put together for you on that.

Mr. BURTON. Would you do that? Would you do that as well?

Mr. MALCOLM. Yes, sir.

Mr. BURTON. Thank you, sir.

Why has FERC only focused on Stage 3 days when considering refunds?

Mr. MADDEN. The Commission, in its order, believed that the Stage 3 was the appropriate time when supply and demand would be out of imbalance, and that it was the time that the FERC should intervene in terms of looking at the prices.

Mr. BURTON. But if you focus solely on the Stage 3 emergency deals, FERC had eliminated more than 81 percent, and according to these records, 57,151 of the transactions above the $150 were—which were, what, in January? In January.

Mr. MADDEN. Mr. Chairman, I believe that came from Commissioner Massey's dissent. But let me say the Commission staff looked at the 70,000 transactions that were filed in January, and determined to look at a proxy as to what price is necessary to mimic the market and sell in at a variable price.

What we did, essentially, was to look at the price of gas, the No_x, and the No_x rate. And the price of gas for January was 12–50 on the spot. Your No_x costs were 22–50, I believe. And we gave 2 pounds for the average CT unit, which would use that, plus the variable cost of $2. And we used a CT unit of 18,000 heat rate unit. And that was based upon the generating facilities that the three IOUs owned.

Mr. BURTON. Did you get all that? OK.

Mr. Filner.

Mr. FILNER. Thank you, Mr. Chairman.

Mr. Madden, the ISO, I think in filings to you, estimated or alleged or said that there was a $6½ billion overcharge by the wholesalers into the market. And you have issued several findings which found a couple hundred million or $60 million at one point, some other figure less. And why is there such a great difference between your findings of overcharges and ISO's?

Mr. MADDEN. Well, Congressman Filner, I am glad you raised that. Because if you were here for the past 2 days of the testifying and the hearing, we now hear that the ISO believes that the $6.7 number that it gave was inappropriate, and that the real number, at most, is $1.3 billion.

Mr. FILNER. When did they say this?

Mr. MADDEN. They have a filing that came into the committee. They now recognize for the first time that figure represents $2.7 billion associated with bilateral contracts, many contracts of which the CPUC reviewed from entities. It also included approximately $900 million associated with non-jurisdictional entities such as L.A. Water and Power.

Mr. FILNER. So they are down to $1.3 billion or whatever?

Mr. MADDEN. They have come down now to $1.3 billion, at most. And we have asked them for further data, which we asked them last week and they did not provide it to us, as to—they account for all the hours in all the days, for the most part. Nor have they told us what the gas prices are and what the No_x credits are.

More importantly, if you look at it, the $1.3 includes also October through December. We have not looked at that period yet at all.

Mr. FILNER. All right.

Mr. MADDEN. And on rehearing, we do have——

Mr. FILNER. If we pass my legislation, you will have the authority to look before October, back to June.

In your findings, when you looked at the overcharges, you only counted during the period of Stage 3 alerts, as I remember it.

Mr. MADDEN. That is what the committee order said.

Mr. FILNER. That seems like a strange thing, because it is at that moment that you would find that there is real competition, I mean, when there is so little left. Why did you not look at other times when price spikes occurred for unaccountable reasons all through the——

Mr. MADDEN. The Commission, in its order, believed that the Stage 3 was appropriate. What we now have to do—it is on rehearing. We discussed the rehearings in April 8th, or this Monday, rather. And one of the issues that you have raised in terms of why not look at a different stage——

Mr. FILNER. What price did you come up with, then?

Mr. MADDEN [continuing]. And a different stage is on rehearing. And I cannot address that because it is a contested case.

Mr. FILNER. OK.

Mr. BURTON. Was it because you had a manpower problem that you did not go beyond Stage 3?

Mr. MADDEN. Oh, no. No. No, Mr. Chairman.

Mr. BURTON. It was not that reason?

Mr. MADDEN. No. We developed on a methodology, and then applied that methodology to the transactions.

Mr. FILNER. Just one final comment, Mr. Chairman. And, Mr. Stout, I appreciate all the charts and who was bidding and when. It reminded me of—I have to quote my friend, Mr. Hunter, again.

He has the best quotes. He said what that bidding represents, really, is if you came into a hospital for a life-and-death operation that was scheduled at a certain time, and 5 minutes before the operation—I am getting this right; right, Duncan?

Mr. HUNTER. Yes.

Mr. FILNER. The administrator of the hospital came in and asked: "what were you willing to pay for the oxygen?" That is, you control a commodity at the moment you need it. It has nothing to do with anything but control at a time that is necessary. And you could charge anything you please at that moment.

I think that is what those bids represent, more than anything. Not that somebody was ready to pay a good price. They needed the electricity at that moment. You controlled it.

Mr. STOUT. If I might respond to that. We still have an offer on the table for forward contracts at 2 cents a kilowatt hour. That is a competitive bid. It is out there.

Mr. FILNER. I will have to look at that. Of course, you guys also control the cost of the natural gas. I mean, the reconciliation that you asked for earlier, Mr. Hunter, how can you reconcile this and that. Because there is a cartel that controls the transportation. I mean, I think the cartel is even smaller than that controls the energy production. So they could charge whatever they please for the natural gas stuff. So we are just moving the cartel from one place to another.

One final question, if I may. You have heard stories about people going out of business in this area. You have heard stories, schools that cannot educate because they are paying these costs, libraries that cannot buy books because they are paying these costs. I have got YMCAs that have closed down because they cannot handle the energy cost.

However you want to look at it, you guys are doing well. I mean, I look at the Fortune 500, I look at your profit statements. Do you feel any responsibility for a situation in which you are making literally hundreds of millions of dollars, and people are bankrupt, people cannot get educated, people cannot get into their YMCA, people on fixed income making life-and-death decisions? Do you have any responsibility for that?

Mr. STOUT. Well, if you are using the word responsibility in a negative connotation, the answer is no, because the profits that we make in this market are rolled back into this market in terms of solutions. We are investing millions of dollars in equipment at our power plants that will reduce emissions from those power plants. We are investing hundreds of millions of dollars in new supply that will bring power to California, that will help to supply the electricity for those hospitals that Mr. Hunter is worried about, and for the elderly citizens who need to have that power in order to have their refrigerator running.

Mr. FILNER. Yeah, but meanwhile you have killed off their business and you have killed off their families, so it is not going to help them too much.

Mr. STOUT. Well, it is certainly not our intent to see that sort of result occur. We hope that the policymakers in California can address that concern in a way that precludes those customers from being harmed. But by the same token, the solution to this market is supply. You have got to get the supply and demand back in balance. And rather than blame suppliers for the problem, we are here to be part of the solution, and we want to have the opportunity to provide that solution.

Mr. FILNER. We have just today one of your fellow producers, Dynegy, told SDG&E that they would close down their operated plants because of a payment problem, a dispute over the payment. There is not a shortage of capacity, it is a question of who controls the ability to give it out. You have Duke Energy in my district had its biggest generator closed down during our Stage 3 alerts.

You keep yelling supply. I will show you example after example the supply is there, and because you guys chose not to use that supply, it put us into an incredibly difficult situation. And you can yell supply all you want, but it is your control that is the problem.

Mr. BURTON. Mr. Horn. Well, you want to go—let me take 2 minutes, real quickly, and then we will yield to Mr. Horn.

Mr. HORN. Chairman, you go ahead.

Mr. BURTON. Thank you. We are not here to beat up on you fellows, although it may appear as though we are being a little aggressive. And we understand that if you have outstanding debts to you, you have got to answer to your stockholders and that sort of thing. And so if they are not paying, it goes down the line.

But this is an extremely difficult situation, and we really need to get as much information and answers as possible, so that if there is a legislative remedy that we can assist California with in Washington, or if we can make some overtures to the EPA to relax some standards so we can get some other forms of generation online to help ease the problem, then we want to do that. But we really need information for us to make some kind of informed decision, and a lot of us are neophytes as far as understanding all the intricacies of the electricity-producing area.

Let me ask FERC this. Why has the floating soft cap changed every month? In December it was $150, in January it was $273, in February it was the Commission that said it would determine a new screening price for each month until the $150 soft cap expired at the end of April. Can you explain that?

Mr. MADDEN. Mr. Chairman, the ISO came in with a filing I believe sometime in 1999, which we approved, to establish a cap. First it was $750, then it was $500, then $250. Up until December 8th there was a hard cap, $250. At which point the ISO made a filing, emergency filing that was discussed yesterday, and to change that $250 cap to a $250 soft cap in order to attract more energy.

The Commission, in its December 15th order, then said starting January 1, from an initial screening standpoint, we will establish a $150 breakpoint, upon which we will look at all those transactions. And those are the 70,000 transactions I talked about that the Commission staff looked at to establish the price. And the $273, as I discussed, is based upon an 18,000 heat rate unit.

You multiply the 18,000 times the 12–50 gas, and you come up with the $273 if you include the No_x prices. And that changes each month, depending what the value of the spot is.

Mr. BURTON. I understand. OK. Why did FERC decide to only seek refunds on electricity sold in excess of $430 per megawatt hour during the Stage 3 alerts in February?

Mr. MADDEN. We used the same methodology as we applied in January, so you had higher gas prices on average for February, No_x went up substantially from $22 to——

Mr. BURTON. So the soft cap went up to $430 because of the formula?

Mr. MADDEN. That is right. The methodology. You just input it.

Mr. BURTON. OK. I got it.

Mr. Hunter, go ahead.

Mr. HUNTER. Thank you, Mr. Chairman. I think it has been a good, informative session.

I think one of the most instructive statements for us, as Californians and San Diegans, was the fact that SDG&E is going to Mexico to build a plant that will transport American—that will receive American transported gas into Mexico, and then presumably export some of the created energy or electricity back into California, because doing all of that is easier than building the plant in California in the first place. Is that the essence of what you said, Mr. John?

Mr. JOHN. What I said, and you are close to it, is for a lot of suppliers these days it is easier to build power plants outside of California than it is within the State.

Mr. HUNTER. OK. I think there is a lesson for all of us here, and I want to go back to the solution that we need to come to, because again we are 60 days away from what could be a disastrous summer.

But we are also looking at a situation where literally thousands of prospective high wage employers who would come and locate in our community, are going to ask in the boardroom to their energy analyst, what is the picture for electricity in San Diego County, CA?

And what they are going to get, at best, probably is, it is uncertain. And that term uncertain will mean that whoever is competing with us for that location of that prized employer for our citizens will probably win, and that company will go elsewhere. Besides driving a number—in my estimation, a number of American or Californian companies are going to be probably moving out of State if things do not get better quickly.

So it is clear that we could build generational capability in California. We are not talking high tech. You make electricity by running—by flowing natural gas through a generator. And most of the big new generators that we make now, like the LM–6000, you bring in and you bolt down on a concrete pad. That is not too complex. And you run pipelines. We have been running pipelines for a long time.

And yet, because of our own laws, regulations, bureaucracy, it takes literally years, roughly half the time it took us to win World War II, to get a permit for a power plant in California.

My question to all of you gentlemen is—and this is kind of a San Diego question—do you have right now in your inventory, Mr. Malcolm and Mr. Stout, do you folks have any 15 to 30 to 50-megawatt generators that you can move in quickly and operate, presuming they are permitted? Do you maintain that kind of inventory?

Mr. MALCOLM. Just recently we had ongoing discussions with parties in California to site new generation, and unfortunately were unable to get the kinds of commitments that we needed in terms of siting, in terms of permitting, that would have allowed us to have new generation on stream by the end of July.

Mr. HUNTER. But you actually could move—have new generation on stream by the end of July if you had permitting and if you had financial backing for those plants?

Mr. MALCOLM. That is correct. We scrambled throughout the country and throughout the world trying to find generation units that we could bring in, and had located some, and very clearly were trying to bring additional units in for the summer. Were unable to do so.

Mr. HUNTER. Would you work with San Diego if we could—if we can——

Mr. MALCOLM. Most assuredly.

Mr. HUNTER [continuing]. If we would be willing to work with you on this project?

Mr. MALCOLM. Sure.

Mr. HUNTER. Mr. Stout.

Mr. STOUT. We had a couple of units earlier this year. In fact, we had nearly 100 megawatts of gas-serving capacity we were trying to locate in California. We approached Southern California Edison. We already had a site. Unfortunately they said their transmission grid was not sufficient to support it. So we were unable to place those. Now it is a little too late.

Mr. BURTON. We will be back to you in a minute.

Ms. Davis.

Ms. DAVIS. Thank you. Just to followup for 1 second, the transmission grid was not supportive. But is there anything in the legislation—there was legislation passed last fall—that precludes you from doing that? Are there any obstacles in that area for you to locate capacity?

Mr. STOUT. I am not familiar with which legislation you are referring to that was passed last fall. Could you clarify that for me?

Ms. DAVIS. Well, there was legislation that made it easier, streamlined some of the processes. And I am just wondering whether—was that helpful? I think, Mr. Madden, you signaled earlier that—or perhaps Mr. John, that it is easier now. Are there additional obstacles that are precluding you from doing something that you would like to do?

Mr. STOUT. I think the most significant obstacle at this point is what I call political and regulatory uncertainty in California. We do not know what this market is going to look like. There are threats of confiscation of power plants. It would be very difficult, I think, for us to go to our boardroom or go to our bankers and request that they loan us hundreds of millions of dollars to invest in California until we have a clear strategic plan on how this market is going to evolve from this point forward.

Ms. DAVIS. One of the things we hear a lot about is municipal power. But I think, you know, you need to understand that one of the reasons that cities are talking about municipal power is because they feel so ripped off. And so it is a shared responsibility that we all have, I think, to do something about this.

What is your sense of cities developing their own ability to regulate their own power?

Mr. MADDEN. Congresswoman, are you talking about the transmission facilities or generation, now?

Ms. DAVIS. Well, I think here in San Diego they are talking about transmission.

Mr. MADDEN. Well, if we are talking about the——

Ms. DAVIS. I am sorry. Generation.

Mr. MADDEN. Oh, generation.

Ms. DAVIS. Right.

Mr. MADDEN. In terms of San Diego itself becoming a muni, for example?

Ms. DAVIS. Yes.

Mr. MADDEN. I think that it should be under consideration in terms of where San Diegans think you will get the most bang for their buck and their value in terms of developing their own generation.

Mr. JOHN. From our standpoint, we have been working with the county and the city. If they want to build their own generation, that is fine with us. And we are also working with independent generators, to try and hook them up to our system as best we can. We have been working with Congressman Hunter's office on issues like that. Especially with respect to the military. We would love to see some new generation built on some of the military bases, if it could get done.

Ms. DAVIS. OK. Well, one final question, if I could go back for a moment. We talked about—and I am sure I appreciate you all have really hung in here, and we appreciate that very much. And my colleagues, as well, have certainly hung in here. I appreciate that.

The issue of the forward contracts came up early on. And I spoke to Mr. Conlon about that. He suggested that in fact there was real mistrust going on quite some time ago, and that contributed to the lack of forward thinking, perhaps, we might suggest. Is one of the problems that—and maybe, Mr. John, you can answer this. What do you think it would have taken for those forward contracts to be developed in concert with the PUC here?

Mr. JOHN. OK.

Ms. DAVIS. It is my understanding that there was a need for a reasonableness clause that was rejected. And correct me if I am wrong on that. What was wrong, what was missing, and how can we improve that? How can we move forward from here?

Mr. JOHN. OK, the issue was that once the Commission started to give us some leeway to deal in the bilateral market, we went to them and said, that is fine. But what we need from you are some up-front reasonableness review criteria, so that if we enter into contracts, we are not going to get a hindsight review a couple of years later and you are going to tell us you paid too much for the power.

And to this day we do not have those standards. If we had—and in some cases we actually brought proposals to the Commission that were negotiated with some of the generators and suppliers, and we tried to say is this OK or is it not? And we could not get a response. So I am not sure it is as much mistrust as it is frustration, because the regulators have not been able to keep pace with the market.

Mr. MADDEN. Congresswoman, if I may, California was unlike many, many other States when they subsequently deregulated the market. And I think Chairman Ose mentioned Pennsylvania. The utilities were not required to divest, as they were in California, all of their portfolio. And when they were, or they had to give up something, they entered into long-term contracts.

You do not have 85, 90 percent of your needs being sold into and bought out of the spot market. It does not make sense. You should have a mixed portfolio of spot, short, mid, and long. That is the best way. And you should also have financial and risk instruments. And a lot of State regulatory agencies recognize the importance of that.

One part of our order, in the December 15th order, we told the State—we told the utilities, as well—that with respect to the generation you have left, the State can do what it wants with respect to the cost, but we want you out of the spot market, and we wanted approximately 95 percent of that remaining generation to be done forward, so that the realtime market would only consist of 5 percent. And so that even if it was volatile at certain points, it would be masked because of the certainty associated with the contract prices you got on the forward market.

Ms. DAVIS. I guess my frustration is, with your expertise and the expertise of the FERC, seeing that, and I am assuming you saw that from the beginning in California, it seems as if there was a point at which you could have intervened, acknowledging that the likelihood of a fair and reasonable market would not occur.

Mr. MADDEN. Well, Mr. Chairman——

Ms. DAVIS. Could you have done that earlier?

Mr. MADDEN. I assumed—and I was not in the position I was earlier, so I assume, though, the Commission could have rejected the ISO's filings. But the history of it indicates there was great deference because California was the first one to unbundle, and they worked at it very hard.

Hindsight is 20/20. But even as late as—or as of 2000 they should have changed their position. They should have allowed the utilities to have a higher level portfolio, and not subject them to prudence reviews if the market does not work out.

Ms. DAVIS. Thank you, Mr.——

Mr. BURTON. The gentlelady's time has expired.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. I do want to share with Congresswoman Davis that Southern California Edison, PG&E, and now Sempra have all said that they do not have a standard by which they could have a safe harbor on long-term contracts. And that is a critical issue here. The testimony we received in Sacramento on Tuesday and on Wednesday was that Southern California Edison and PG&E and I believe Sempra, also——

Mr. JOHN. SDG&E.

Mr. OSE [continuing]. San Diego Gas was into PUC late last summer and early last fall asking for those standards to be finalized, and they have yet to receive finalized standards. It is a huge problem, because it creates such uncertainty. And I appreciate you asking that question.

As far as Mr. Stout and Mr. Malcolm, in terms of either Williams or Reliant, are either of your companies contracted with the State of California, through the Governor's office, on any of these contracts that we cannot seem to get any information about?

Mr. MALCOLM. Yes, we have entered into a 10-year, fixed price, 1,400 megawatt contract.

Mr. OSE. How about you, Mr. Stout?

Mr. STOUT. Reliant had a short—I think it was around a 30-day contract. That has since expired. We do not have any long-term contract.

Mr. OSE. The reason I ask that question is that ultimately the question of transaction relating to the transmission lines, as I understand it, falls under the jurisdiction of the FERC.

Mr. MADDEN. That is correct.

Mr. OSE. And we may well need to understand the financial implications of these long-term contracts that the Governor's office has arranged, but for which we cannot get any information. Would you be willing to, under seal, provide us with a copy of your contract so that we can at least have some information as it relates to that?

Mr. MALCOLM. I am sure something can be arranged.

Mr. OSE. I appreciate your offer, because—and I will say that the others that we have asked that have also consented to provide us that information, and I am appreciative of it.

One final point, Mr. Chairman. Mr. John's company has technology that is relatively old. But, well, excuse me. Your generating capacity before you sold it was relatively dated?

Mr. JOHN. Yes.

Mr. OSE. Mr. Malcolm's company and Mr. Stout's company are forced, just by economics, to produce the power at the lowest possible price, and thereby generating the returns that their capital partners and the like will want. And the interesting thing about that is that in non-attainment areas like the Sacramento Valley and the San Joaquin Valley and elsewhere across the country, they can bring to the market power. In other words, they can convert natural gas to electricity at up to 50 percent more efficiently using new technology than old, at a 25 to 50 percent reduction in emissions. Whether it be nitrous oxide or sulfur dioxide or what have you. And the issue that we need to figure out is how to help increase supply in such a manner that it is positive for the environment. These are things that we can do.

Now, Duncan cited the issue of regulatory burden being one of the factors pushing the construction of these plants into Mexico. I am curious whether we can work with FERC on such a manner where some improvement of conversion or some decrease in emission, the Federal Government can give the opt-out for a company to move ahead in a regulatory environment. I think this is absolutely a huge opportunity for us. And I hope that as we contemplate the information we have received over the past 3-days hearing from all the witnesses, that we are able to take that and put it into legislation that will make something happen, and relieve the supply crisis that we have here. Thank you, Mr. Chairman.

Mr. HUNTER. Doug, would you yield for 1 second on that?

Mr. BURTON. We are going to you next. But we certainly will try, and that is the whole purpose of all this.

Mr. Hunter.

Mr. HUNTER. Yeah, thank you, Mr. Chairman. Doug, I think you have pointed out a path that would be a very wise path for us to follow. Because what we have now is a situation, it is like buying a car, and you are told you buy the technology. If you want to buy the earliest technology you possibly can have, in the year 2000 the newest car you can have is a 1990. And the reason you cannot have a 1995 or a 1996 or a 1999 or a 2000 model is because it takes you so long to get that online, so when you get something online, almost by definition, somewhat analogous to our military systems, it would take us a long time to develop. You do not have the state-of-the-art.

And so, Doug, it would seem to me your point or your recommendation that, in exchange for eliminating this 18-month permitting time, if you promise and you commit to the regulatory agency that you are going to use the highest technology available—in fact, you may even get that down to where you specify models and types of equipment—and the bureaucracy can look at that and say that is going to put 50 percent less emissions into the field, into the air. Is it in our interest, as a government, to delay the new stuff, and thereby guarantee we are going to have the old model continuing to operate for the next 5 years? Or is it in our interest to go to a 1-month permitting time, and thereby get the new model into the field, help the environment at the same time we are getting new stuff online? Now, does that make sense to you guys?

Mr. MADDEN. Well, it makes sense to me to get the dirtier plants off, and get the more efficient steam, CT plants in. And that is what we mentioned in our March 14th order.

You have got to send the right price signals for that to be accomplished. And, you know, the regulatory prohibitions, in terms of the timing, I think really need to be changed dramatically, and they have to come down. It does not make sense when everyone wants a site outside of California. It does not make sense.

Mr. JOHN. The only thing I would add is, we have talked a lot today about generation, appropriately. We have talked about gas transmission. But the same issue applies to electric transmission. And you have to have electricity transmission either upgraded or built in order to hook into some of these generation facilities. And it is harder to build transmission, especially in California, than it is generation.

Mr. HUNTER. Is that right?

Mr. JOHN. Yes.

Mr. HUNTER. Mr. John, just one point on that. I am trying to go back to getting through the summer again. You folks have substations around San Diego County, obviously.

Mr. JOHN. Yes.

Mr. HUNTER. It looks to me like a substation, if you are going to try to have some distributive generation capability, the best place to have that is at a substation, because you obviously have got your fuel there and you have got your line there; right? Is there a lot of capacity at the substations to put in an extra 50 megawatts, 10 megawatts, 20 megawatts?

Mr. JOHN. I do not know the actual amount, but I do know that the people over at SDG&E have been working with certain developers on—but I do not have the specifics. I can get that for you.

Mr. HUNTER. OK. Thank you. And I want to thank everybody here, Mr. Chairman, for their testimony. And, Mr. John, thanks to you folks for working with Bob Simmons, who is the president of the Coalition for Electricity Independence. I think that it is a bunch of businesses trying to get the answer here and get stuff online. Thank you, Mr. Chairman.

Mr. BURTON. I think Mr. Filner has one last question.

Mr. FILNER. Mr. Malcolm, Mr. Stout, you have put yourselves in this position and I thank you. I mean, you had to take a lot from us, and we appreciate your being here and answering our questions.

Mr. John, we heard an offer for 2 cents plus the price of natural gas. There must be something wrong with that offer.

Mr. JOHN. And last year we heard 5 cents. Again, everybody—it has either been made in the newspapers or in congressional hearings. And the problem is, when we then sit down and try and have discussions with the generators, it is almost like a bait-and-switch. You know, all I can tell you is in previous discussions we have had with certain generators, they have said one thing in public; and then when we sat down to negotiate, new bells and whistles get added and the 2 cents becomes 10 cents or 12 cents.

Mr. BURTON. Let me just say that if some kind of an overture is made on the 2 cent issue and it does materialize, give me a call and we will have everybody come to Washington and talk about it. And we will just ask you to come out. And, I mean, if this offer that was made today is a valid offer, and you take him up on it, and it does not work out, our committee has oversight over the entire Federal Government, which has ancillary responsibility for what is going on here through Federal agencies. We will be happy to have people come out there and we will discuss it in an open forum.

Let me just say we have some more questions for the record, but I do not want to keep you people here overnight. So if you do not mind, we would like to submit some questions to you for the record, and if you can have your staffs or you answer those questions and get them back to us, along with the other information which we have asked for, we sure would appreciate it. And if you get that information back to us that we ask for in a timely way, then I think that will probably conclude what we have to do out here in California.

And with that, if there is no more questions, thank you for being here. We appreciate it. We stand adjourned. Thank you.

[Whereupon, the committee was adjourned at 3:09 p.m.]

[Additional information submitted for the hearing record follows:]

ONE HUNDRED SEVENTH CONGRESS

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May 23, 2001

Mr. Steve Malcolm
President
Williams Energy Services
1 Williams Center
Tulsa, Ok 74172

Dear Mr. Malcolm:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 12 in San Diego. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Profits in California

During the April 12 hearing, your were asked a number of questions about Williams' profits, both nationally and in California. You did not have that information available at the hearing, but offered to provide it.

Please respond to the following questions:

1. What was Williams Energy Service's total revenue and total profit in 1999 and 2000? How much revenue and profit did Williams earn each year in the California market?

2. Did Williams' California profits increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

3. What percentage of your total natural gas load requirement do you obtain on the spot market?

Mr. Steve Malcolm
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Plant Outages

During the April 12 hearing, you were asked a number of questions about FERC's show cause order and the Williams AES Southland plant outages at the Alamitos and Huntington Beach plants. For example you were asked if $63 is a good estimate of your fixed costs. However you didn't have that information available at the hearing.

Please respond to the following questions:

1. Is $63 a good estimate of your fixed costs at the Alamitos and Huntington Beach plants during the outage last year?

2. If not, please provide the Committee with a good faith estimate of your fixed costs for the two plants during the outage.

4. Since the April 12 hearing, Williams settled with FERC by agreeing to pay the ISO $8 million without an admission of guilt. During the hearing you stated, "the show cause order was very one-sided and very biased." Given your statements at the hearing, why did Williams choose to settle the case?

5. What is Williams' position on FERC's order requiring Williams to offer the ISO non-RMR units at the RMR rate if an RMR unit at either Alamitos or Huntington Beach is on a forced outage?

The April 30 consent agreement issued by FERC stated the following:

"In materials that Williams voluntarily provided to the Commission staff in the investigation, Williams disclosed that a non-managerial operations employee of Williams indicated to AES Southland that Williams did not object to the extension of the Alamitos 4 outage and the employee's belief that Williams could provide a financial incentive for AES Southland to extend the outage."

1. Does Williams agree with the characterization in Paragraph G of the agreement?

2. What financial incentive did the employee offer to AES to extend this outage?

3. Did this act prolong the Alamitos 4 outage?

4. What measures has Williams taken to ensure this does not happen in the future?

Mr. Steve Malcolm
May 23, 2001
Page 3

5. Please provide to the Committee all materials cited in Paragraph G of the consent agreement that Williams provided FERC, including documents, audio or video tapes, handwritten notes, and other material.

The April 30 consent agreement issued by FERC also stated:

"The second notice cited a need to dredge the plant's circulation tunnels. Mussel shells and silt had accumulated in the tunnels, causing operational problems. Edison had, when it owned the facility, successfully addressed the problem posed by mussel larvae by scheduling and performing "heat treats," heating the water in the circulation tunnels, and thereby killing the larvae. This practice was discontinued in mid-summer 1998 after AES acquired ownership of the plant, but while the Edison-AES Huntington Beach L.L.C. Operation and Maintenance Agreement still governed operation of the plant."

1. Why did AES discontinue performing "heat treats" at the Huntington Beach 2 unit in 1998 as referred to in Paragraph J of the agreement?

2. Has AES resumed using "heat treats" on the circulation tunnels?

3. In your testimony, you stated that you would provide materials showing this was a necessary outage. Please provide to the Committee this documentation.

Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers in California. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Mr. Steve Malcolm
May 23, 2001
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5. Recently Williams declared its support for price caps in the Western region. Why has Williams changed its position on this issue? How long do you think the price caps should last? Would the imposition of price caps increase the risk of blackouts in California? Would the imposition of price caps increase or reduce the incentive to build new power plants in the Western region?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Please provide this information to the Committee no later than May 29, 2001. If you have any questions please have your staff contact Caroline Katzin at (202) 225-5074. Your assistance is appreciated.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

cc: The Honorable Henry Waxman
Ranking Minority Member

Williams

One Williams Center
P.O. Box 2400
Tulsa, Oklahoma 74102
918/573-2000

June 6, 2001

The Honorable Dan Burton
Chairman
Committee on Government Reform

The Honorable Doug Ose
Chairman
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs
United States House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515

RE: April 12, 2001 Hearing of the Committee on Government Reform on the California Electricity Crisis

Dear Chairman Burton and Chairman Ose:

With respect to your letter dated May 23, 2001, submitting a series of follow-up questions regarding issues raised at the April 12, 2001 hearing on the California Electricity Crisis, I am pleased to provide you with the following responses.

Profits in California

1) Question: What was Williams Energy Services' total revenue and total profit in 1999 and 2000? How much revenue and profit did Williams earn each year in the California market?

Response: Per Note 23 to The Williams Companies, Inc.'s, 2000 Consolidated Financial Statements, the reported Segment Profit for Williams Energy Services for year 1999 is $529,100,000, and for year 2000 is $1,558,700,000. The reported revenues for Williams Energy Services for year 1999 is $4,900,700,000, and for year 2000 is $8,055,500,000. With respect to your question regarding how much revenue and profit Williams earned in the California market, Williams does not report earnings segregated by geographic region, and, accordingly, we do not possess such information. While a calculation could be done to determine these numbers, such a calculation would be burdensome, difficult to make with precision, and disclosure of such financial information in this forum could violate SEC regulations preventing selective disclosure. It is important to note, however, that Williams sells most of its power in California under long-term contracts, at prices well below prevailing spot-market prices.

2) Question: Did Williams' California profits increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

Response: As noted in the response to your first question, Williams does not segregate earnings by geographic region. The majority of the power relating to Williams' reported profits relates to contracts for forward sales, not sales in the real-time markets to which price caps would apply. Nonetheless, Williams actively opposed the reductions to the price caps that occurred during the summer of 2000. It is Williams' general impression that reducing the price caps during the summer of 2000 did not reduce the overall cost of power in the market, and this is supported by the California Independent System Operator ("ISO"). In a report dated September 6, 2000, and released by the ISO's Market Surveillance Committee ("MSC"), entitled "An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Markets," the MSC found that "monthly average energy prices during June 2000, when the price cap was \$750/MWh, were lower than monthly average energy prices during August 2000, when the price cap was \$250/MWh. This result occurred despite the fact that virtually the same amount of energy was consumed in California during these two months."[1] Id. at 2-3.

3) Question: What percentage of your total natural gas load requirement do you obtain on the spot market?

Response: The amount of gas that Williams obtains on the spot market varies from day-to-day. Williams' general practice is to purchase gas forward for long-term deals and buy spot gas day ahead for short-term transactions. In addition, Williams sells the majority of its available power through long-term deals. At this point in time, well over three-quarters of the power available to Williams is sold under long-term contracts.

[1] As Chairman Hébert noted in his concurring opinion to FERC's November 1 Order proposing remedies for the California wholesale electric markets, "the Commission's own Staff Report suggests that there is a direct correlation between lower price caps and higher consumer prices. Specifically, it finds that decreases in the ISO price cap this past summer were matched by increases in exports of electricity out of California during the same period. The resulting decrease in net imports, historically relied upon by California, is one of the principle reasons for the increase in wholesale electricity prices." San Diego Gas & Electric Co., et al., 93 FERC ¶ 61,121, 61,384-61,385 (2000) (Hébert concurring).

Plant Outages

1) Question: Is $63 a good estimate of your fixed costs at the Alamitos and Huntington Beach plants during the outage last year?

Response: No.

2) Question: If not, please provide the Committee with a good faith estimate of your fixed costs for the two plants during the outage.

Response: Annual payments to AES per Williams' Tolling Agreement with AES for Alamitos 4 and Huntington Beach 2, and fixed costs per MWh, are as follows:

Alamitos 4:	$9,688,000 ($9.41/MWh)
Huntington Beach 2:	$7,480,000 ($12.05/MWh)

However, these amounts only include annual payments to AES and do not include corporate overhead or other fixed costs and do not include variable costs such as fuel, NOx and variable operating and maintenance expenses.

3) Question: Since the April 12 hearing, Williams settled with FERC by agreeing to pay the ISO $8 million without an admission of guilt. During the hearing you stated, "the show cause order was very one-sided and very biased." Given your statements at the hearing, why did Williams choose to settle the case?

Response: Williams did not agree to pay the ISO $8 million; rather, Williams agreed to refund $8 million to the ISO by crediting outstanding invoices due from the ISO. Additionally, on May 1, 2001, Williams issued the following statement to the press, and it accurately conveys the reasons for which Williams chose to settle: "FERC has terminated the show-cause proceeding without any finding of wrongdoing by Williams. We are confident that a full hearing of the facts would have exonerated us entirely, but were willing to settle this matter in order to turn our full attention to helping shape solutions to energy issues facing California and the nation. Settling the matter provided the best opportunity for Williams to move forward on more productive matters, instead of engaging in a lengthy and costly hearing process."

4) Question: What is Williams' position on FERC's order requiring Williams to offer the ISO non-RMR units at the RMR rate if an RMR unit at either Alamitos or Huntington Beach is on a forced outage?

Response: In Section III(B) of the Stipulation and Consent Agreement entered into between Williams, AES and FERC's Market Oversight and Enforcement

Section, Williams voluntarily agreed to the following provision: "For one year after the Commission approves this Agreement, Williams agrees to accept the following condition on its market-based rate authority. If an RMR unit at the Alamitos or Huntington Beach plants that the ISO would have dispatched to provide voltage support or other reliability service, consistent with applicable RMR agreements, is unavailable due to a forced outage, the ISO may call a non-RMR unit, at either the Alamitos or Huntington Beach plants, to provide that service for the same compensation, including applicable availability amounts, and under the same terms had the RMR units been available; provided that Williams' obligation under this paragraph will in no event extend to more than a total of two non-RMR units at any one time." FERC approved the Stipulation and Consent Agreement, and thus the above provision, in its April 30, 2001 Order concluding the Show Cause proceedings. See AES Southland, Inc., et al., 95 FERC ¶ 61,167 (2001).

5) Question: The April 30 consent agreement issued by FERC stated the following:

"In materials that Williams voluntarily provided to the Commission staff in the investigation, Williams disclosed that a non-managerial operations employee of Williams indicated to AES Southland that Williams did not object to the extension of the Alamitos 4 outage and the employee's belief that Williams could provide a financial incentive for AES Southland to extend the outage."

(a) Does Williams agree with the characterization in Paragraph G of the agreement.

Response: Williams is a signatory to the Stipulation and Consent Agreement, and, as such, may be limited in how it might characterize the above-quoted paragraph. However, it is important to recognize that the above-quoted language from Section II(G) is incomplete. Section II(G) goes on to provide that, "However, Williams did not ultimately pay to AES Southland any financial inducement to extend the outage and AES Southland maintained control of the outage schedule." This last sentence is an integral part of Section II(G). See AES Southland, Inc., et al., Stipulation and Consent Agreement at 10.

(b) What financial incentive did the employee offer to AES to extend the outage?

Response: Williams is a signatory to the Stipulation and Consent Agreement, and, as such, may be limited in how it might characterize the above-quoted paragraph. As Williams agreed in Section II(G) of the Stipulation and Consent Agreement, "Specifically, the employee indicated that the proposed extension of the outage would not count against the availability of the unit." Id. This "indication" was not an offer made on behalf of Williams. Further, the Williams employee involved in this matter would not be in a position to authorize anything that would generate a financial incentive for either Williams or AES. Finally, as noted in the above Response, Williams did not, in fact, provide AES with any financial inducement to extend the outage.

(c) Did this act prolong the Alamitos 4 outage?

Response: To the best of our knowledge, it had no impact on the outage. The occurrence and duration of the outage was at all times in the control of AES. The original Alamitos 4 outage request was for a five day period from April 25, 2000 at 0001 hours to April 30, 2000 at 0001 hours. The request was for a maintenance outage to repair a boiler tube leak. On April 28, AES requested an extension of the outage for an additional six days to May 5. The request was to perform repairs to the heater drip line and also to repair damaged burners.

(d) What measures has Williams taken to ensure this does not happen in the future?

Response: Williams has provided additional training to all employees regarding Williams' duties and obligations under our Tolling Agreement with AES to prevent even the appearance of impropriety in dealings between Williams and AES. Additionally, attorneys in Williams' legal department offer training in anti-trust issues to Williams' employees on a continuing basis.

Price Controls

1) Question: Recently Williams declared its support for price caps in the Western region. Why has Williams changed its position on this issue? How long do you think the price caps should last? Would the imposition of price caps increase the risk of blackouts in California? Would the imposition of price caps increase or reduce the incentive to build new power plants in the Western region?

Response: Williams has not supported regional price caps but, instead, has declared its support for regional price controls. Under a price cap, prices cannot exceed an absolute, arbitrary dollar amount.[2] However, under price controls, a formula is developed that takes into account actual costs and the ability to achieve a reasonable profit. Williams is still opposed to price caps, and our willingness to explore price controls is not inconsistent with

[2] As discussed above, however, during Summer 2000, as California lowered its purchase price caps, the average price of electricity actually increased.

our position on price caps. For your reference, attached as "Attachment A" is a press release issued by Williams on April 25, 2001, discussing Williams' position on price controls.
Price controls should be of limited duration, and should be in effect no longer than through Summer 2002.
Price caps would increase blackouts in California, as caps would discourage investment in the State and encourage exporting of supply in search of uncapped markets. Of equally important concern, to the extent that price caps are not designed to allow for recovery of costs – perhaps even variable costs, including the fluctuating price of natural gas – the danger persists that independent power producers will not be capable of sustaining production. This is not a theoretical problem – several thousand megawatts of power have been unavailable over the past several months as independent power suppliers have faced their own cashflow problems in this market. Reasonable price controls, however, would not increase the risk of blackouts in California, especially if the controls are of a regional nature and if it is absolutely clear that this is an interim measure with a very definite termination date. For this reason, Williams supports regional price controls, rather than controls limited to California.
A reasonable price control of limited duration would not have a materially negative affect on the incentive to build new power plants in the West, but a price cap certainly would. Additionally, the majority of new projects will not be in service until after the current expiration of price controls. Further, it is critically important to note that this concept is considered as part of a comprehensive solution, which would include measures to guarantee payment for past and future sales.

Market Monitoring and Mitigation Order

1) Question: Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

Response: Williams understands that there is an argument that FERC exceeded its authority in imposing certain requirements on municipalities and PMAs. Williams does not know whether they will abide with FERC's market monitoring and mitigation plan, but Williams is hopeful that all market participants, even non-jurisdictional entities, will endeavor to fully cooperate in bringing about a final resolution to the current crisis.

2) Question: Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

Response: It is worth noting that Williams has executed long-term contracts with various parties, including those who might be characterized as energy brokers, since it has been active in the California market. We have been successful in our efforts to sell the majority of the power available to us under long-term contracts. We continue to consider it most unfortunate that the State of California precluded its regulated utilities from negotiating such contracts, which could have allowed for significant mitigation of the price Californians have paid for power over the past several months. Williams has no control over the pricing decisions of the so-called energy brokers when they resell power they have purchased from us. However, Williams believes that FERC's market monitoring and mitigation order properly addresses energy brokers. In its mitigation plan, FERC directed that "during mitigation, marketers can accept the market clearing proxy price or submit their own bid. If their bid exceeds the market clearing price, they would be required to justify the bid based on the prices they paid for power." San Diego Gas & Electric Co., et al., 95 FERC ¶ 61,115 (2001), at 16-17. (emphasis added). Hence, the activity of energy brokers will continue to be subject to close FERC scrutiny.

3) Question: Will the plan protect consumers from megawatt laundering?

Response: Williams is not aware of any megawatt laundering actually taking place. However, to the extent that any market participant will attempt to engage in such activity, FERC has specifically addressed the issue. In its mitigation plan, FERC noted that, "Several commenters are concerned about generators avoiding the must-offer requirement. They raise concerns about so-called 'megawatt laundering' where a supplier schedules supply out-of-state and then reimports that power to avoid a mitigated price. They also contend that imports must be included in the proposal to cap prices for all sales into the ISO market, not just sales made by PGA generators. The Commission recognizes that the California market is integrated with those of other states, and for that reason, is instituting an investigation into public utility sales for resale in the WSCC. In addition, as discussed above, to ensure that the mitigation and monitoring proposal is applied equally to all generators in California, the must-offer obligation will be applied to include non-public utility generators in California which currently make use of the ISO's interstate transmission grid." Id. at 11. Thus, Williams is confident that FERC will actively monitor the market and take prompt action should it discover any improper activity.

If you have should have any questions, please contact me at (918) 573-4401, Alex Goldberg, Senior Regulatory Counsel, at (918) 573-3901, or Glen Jackson, who has responsibility for coordinating our federal legislative efforts, at (202) 833-8994.

Chairmen Burton and Ose
June 6, 2001
Page 8

Respectfully submitted,

Steve Malcolm/mm

Steve Malcolm
President
Williams Energy Services

cc: The Honorable Henry Waxman
Ranking Minority Member

ATTACHMENT “A”

Williams

04/25/01

Williams Supports Short-Term Regional Price Controls to Help Address California Power Crisis

TULSA -- The chairman of Williams (NYSE:WMB) said today the company supports short-term regional price controls as one measure to help California and other western states address the effects of high electricity prices that are being driven by an inability to produce enough power to meet demand.

"Williams understands that any form of long-term price control is counter-productive to creating adequate energy supply and efficient pricing. This has been true in any market at any time in our history," said Keith E. Bailey, chairman, president and chief executive officer. "But, we also recognize this is an extraordinary situation. We need to help create some breathing room over the next year or so to allow the current emergency supply initiatives to have a meaningful impact. We all have to work together, and this is the right thing to do.

"We also believe a rational course of action that seeks new sources of supply must be combined with public policy that ensures confidence that services provided in the past and future will be paid in full. It is also imperative to design controls in a manner that allows full recovery of costs and a return that is commensurate with risk," he said. "The combination of short-term, regional price controls during emergency periods that eventually expire at a fixed point in time, along with the elimination of credit risk, should provide the market a respite while creating incentive for the private sector to invest with confidence. All these elements are essential."

Williams markets some 4,000 megawatts of power in California, the majority of which was sold in long-term, forward contracts both this year and last.

Bailey said Williams has net accounts receivable at March 31 for power sales to the California Independent System Operator and the California Power Exchange of about $252 million, a net increase of approximately $140 million from year-end 2000. "This is consistent with our ongoing commitment to continue to serve California markets while we work toward finding equitable solutions to the energy crisis," Bailey said. He said Williams started power sales to the Department of Water Resources on April 1 under a long-term agreement signed earlier this year.

About Williams

Williams, through its subsidiaries, connects businesses to energy. The company delivers innovative, reliable products and services. Williams information is available at http://www.williams.com.

Portions of this document may constitute "forward-looking statements" as defined by federal law. Although the company believes any such statements are based on reasonable assumptions, there is no assurance that actual outcomes will not be materially different. Any such statements are made in reliance on the "safe harbor" protections provided under the Private Securities Reform Act of 1995. Additional information about issues that could lead to material changes in performance is contained in the company's annual reports filed with the Securities and Exchange Commission

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Contact Information:

Paula Hall-Collins, Williams Media Relations (918) 573-3332 *paula.hall-collins@williams.com*	Rick Rodekohr, Investor relations (918) 573-2087 *rick.rodekohr@williams.com*	D'Ann Riley, Investor relations (918) 573-8088 *d'ann.riley@williams.com*

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Congress of the United States

House of Representatives

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May 23, 2001

Mr. John Stout
Senior Vice President for Asset Commercialization
Reliant Energy
1111 Louisiana Street
Houston, TX 77002

Dear Mr. Stout:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 12 in San Diego. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Profits in California

During the April 12 hearing, you were asked a number of questions about Reliant's profits nationally and in California. You did not have that information available at the hearing, but offered to provide it.

Please respond to the following questions:

1. What was Reliant Energy's total revenue and total profit in 1999 and 2000? How much revenue and profit did Reliant earn each year in the California market?

2. Did Reliant's California profit increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

3. What percentage of your total natural gas load requirement do you obtain on the spot market?

Mr. John Stout
May 23, 2001
Page 2

Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers in California. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Other Questions

1. The Governor and numerous state lawmakers have made repeated threats to seize power plants through the use of eminent domain. How does this affect your company's decisions to invest in California?

2. Have the State's new plant siting policies encouraged your company to build new plants in California, and has the siting process been expedited as claimed?

Mr. John Stout
May 23, 2001
Page 3

4. The Ninth Circuit recently lifted a lower court injunction forcing Reliant Energy to sell electricity to the California Independent System Operator (ISO) without assurances of payment. How does this affect Reliant's position on sales of electricity to California?

5. Why has your company decided to sell a majority of its power generated in California to entities outside of the state when California is facing a supply shortfall?

6. In preliminary orders issued earlier this year, FERC determined that Reliant overcharged California entities by $20 million in January and February, and required Reliant to refund that amount. Do you agree or disagree with FERC's determination? Please explain why.

7. Why did Reliant file a complaint with FERC last month charging the Cal-ISO with interfering in properly scheduled maintenance outages?

Please provide this information to the Committee no later than May 29, 2001. If you have any questions, please have your staff contact Caroline Katzin at (202) 225-5074. Your assistance is appreciated.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

cc: The Honorable Henry Waxman
Ranking Minority Member

FACSIMILE COVER SHEET

DATE:May 29, 2001

NUMBER OF PAGES: 6
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FROM: Bud Albright

PLEASE DISTRIBUTE TO THE FOLLOWING PEOPLE IN YOUR AREA:

The Honorable Dan Burton
The Honorable Doug Ose

If there are problems receiving this **FAX**, please call Susan or Denice at (202)783-7220 Thank you.

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May 29, 2001

The Honorable Dan Burton
Chairman, Committee on Government Reform
The Honorable Doug Ose
Chairman, Subcommittee on Energy Policy,
Natural Resources and Regulatory Affairs
United States House of Representatives
Committee on Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman Burton and Ose:

In response to your request for additional information dated May 23, 2001 addressed to Mr. John Stout, attached are copies of the responses that have been prepared to your questions.

There are several questions that call for the production of confidential information. As Mr. Stout indicated at the time of the hearing, appropriate confidentiality protections need to be put into place to protect this commercially sensitive information from disclosure. I have attempted to contact Committee staff to discuss this issue in order to determine whether there is information that could be provided to you to address your concerns on a nonconfidential basis. With regard to the balance of the materials, I trust that if you have any questions concerning any of the responses attached, that you will contact us.

We appreciate the opportunity to participate in the Committee's hearings and look forward to continuing to work with the Committee on these important matters.

Sincerely,

Bud Albright

Bud Albright

Attachment

Question 1 -
What was Reliant Energy's total revenue and total profit in 1999 and 2000? How much revenue and profit did Reliant earn each year in the California market?

Answer...We have interpreted the reference to "profit" in your question to mean "net income". Reliant Energy's total revenue and net income for 1999 and 2000, as publicly reported is shown in the following table (all values in $ million):

	1999	2000
Revenues	$15,223	$29,339
Net Income	$1,482	$447

With respect to the second half of the question, the requested information will be provided upon the satisfactory resolution of concerns over the confidentiality of such information.

Question 2
Did Reliant's California profit increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

Answer... From our analysis, it does not appear that monthly operating income increased after the price caps were lowered in August of last year.

With respect to the second half of the question, the requested information will be provided upon the satisfactory resolution of concerns over the confidentiality of such information

Question 3
What percentage of your total natural gas load requirement do you obtain on the spot market?

Answer...We obtain natural gas in the spot market in balance with the amount of electricity we sell into the spot market. During the first quarter of 2001, that percentage was approximately 65%.

MARKET MITIGATION PLAN

Question 1
Do you believe that FERC's market mitigation plan will help keep prices down this summer?

Answer...Yes, FERC's market mitigation plan implements a variable cost cap during Stage 1, 2, and 3 emergencies that is likely to reduce market prices, both spot and term, for this summer by inappropriately excluding several basic cost components. In fact, based on current gas prices, the FERC order would limit clearing prices based on our facilities to less than $230/mwh, a level lower than any of the hard caps used by the ISO in past years. We further expect the ISO to be in Stage 1 or higher most of the hours during the summer season, resulting in a corresponding application of the FERC mitigation plan for most hours.

Question 2
Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

Answer...We believe that some elements of the FERC mitigation plan will increase the probability of blackouts this summer. Specifically, the lower wholesale prices, as explained above, and failure to recognize real business costs, such as opportunity costs, as justifiable, will likely increase peak demand and reduce supply imports from energy constrained resources, particularly Canadian hydro.

<u>Question 3</u>
Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?

Answer...As indicated in our response to question 2, we believe that the FERC mitigation plan will reduce imports into California. In particular, failure to recognize costs such as opportunity costs as legitimate bid justification will force hydro resources to be retained for local use. If a limited hydro resource is sold into California during a capacity shortage, the owner risks purchasing replacement energy at a later time. The cost of that replacement energy is a rational business basis for bidding above production cost and should not be prohibited under the FERC mitigation plan.

<u>Question 4</u>
Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Answer...Extending the FERC California market mitigation plan to the entire WSCC may not be practical since the rest of the WSCC lacks a visible spot market based on a single clearing price. Without such, it is difficult to understand how the mitigation plan used in California could function since it depends on a single market clearing price.

PMA's

<u>Question 1</u>
Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

Answer...Our interpretation of the proposed FERC order is that the California market mitigation plan is applicable to PMA's and municipalities due to the fact that they utilize the ISO's interstate transmission grid. The relevant language is found on pg. 10-11 of the order.

<u>Question 2</u>
Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

Answer...We do not believe that energy brokers are exempted from the mitigation plan proposed by the FERC order. Page 17 clearly states marketers must accept the proxy price or they must justify their bids based on the price they actually paid for the power.

<u>Question 3</u>
Will the plan protect consumers from megawatt laundering?

Answer...We must first clarify what we believe you are referring to as "megawatt laundering". Some parties have alleged that suppliers "launder" megawatts by selling forward contracts to other parties who in turn may sell that energy back to California through the ISO spot markets. We do not feel that such is "laundering" because the original supplier does not benefit financially from the spot market sale, all they receive is the original sale price. Such transactions are straightforward examples of forward hedging to avoid risk in the spot market. With respect to your question, our understanding of what is meant by the term megawatt laundering requires the original supplier to receive additional compensation that is directly related to the compensation received from the subsequent resale into the CAISO market. That said, the proposed FERC order has clear protections against this type of abuse. Any power being sold back into the ISO market from a party outside the ISO during tight supply situations must be sold at the mitigated market clearing price, or the seller must justify the cost basis of the transaction. If the seller chooses the latter approach, FERC has the authority to audit the supporting documentation, and should therefore be able to detect the type of contractual arrangements that we believe would be considered laundering.

OTHER QUESTIONS

<u>Question 1</u>
The Governor and numerous state lawmakers have made repeated threats to seize power plants through the use of eminent domain. How does this affect your company's decisions to invest in California?

Answer...The political and regulatory environment in California is a major factor that necessarily impacts Reliant's business decisions on whether to make new investments in the State. Given the substantial need for new energy infrastructure across the U.S., California's instability diminishes its value as an investment option relative to other regions of the country.

<u>Question 2</u>
Have the State's new plant siting policies encourage your company to build new plants in California, and has the siting process been expedited as claimed?

Answer...California has made progress in expediting the power plant siting process. However, this progress has been offset by increasing political and regulatory instability. The risks posed by this instability would be a major factor in any decision by Reliant to build a new power plant in California.

<u>Question 3</u> **- No question listed with this number**

<u>Question 4</u>
The Ninth Circuit recently lifted a lower court injunction forcing Reliant Energy to sell electricity to the California Independent System Operator (ISO) without assurances of payment. How does this affect Reliant's position on sales of electricity to California?

Answer...If the CAISO complied with the provisions of its FERC-approved tariff and the requirements of a recent FERC Order requiring the CAISO to adhere to the creditworthiness standards in its tariff, the Ninth Circuit's action would have no impact on our sales to California. Unfortunately, recent public pronouncements by the CAISO (Statement of Terry Winter before House Committee on Government Reform, Sacramento, Ca, Field Hearing, April 10, 2001 and the CAISO compliance filing on creditworthiness requirements, submitted to FERC on May 11, 2001) indicate that CAISO does not intend to fully comply with the creditworthiness requirements in its tariff. The lack of tariff compliance has a destabilizing impact on the market and increases the risk of blackouts.

<u>Question 5</u>
Why has your company decided to sell a majority of its power generated in California to entities outside of the state when California is facing a supply shortfall?

Answer...This question is factually inaccurate. Our company has not sold the majority of its energy to entities outside the state of California. During 2000 the energy sold outside of California represented about 6% of the total energy we produced.

Question 6
In preliminary orders issued earlier this year, FERC determined that Reliant overcharged California entities by $20 million in January and February, and required Reliant to refund that amount. Do you agree or disagree with FERC's determination? Please explain why.

Answer...We disagree with FERC's calculation of the amount and with the characterization of the $20 million as an overcharge. We believe that the FERC order simply used a generic screening tool to identify transactions for which detailed cost justification in required. We have submitted the requested cost justification, but FERC has not yet ruled on the adequacy of our justification package. We believe that the inclusion of daily versus monthly fuel cost differences, opportunity costs, and risk premiums fully justify the bids in question.

Question 7
Why did Reliant file a complaint with FERC last month charging the Cal-ISO with interfering in properly scheduled maintenance outages?

Answer... As detailed in the complaint, Reliant had a previously scheduled maintenance outage planned for Etiwanda Unit 3. This outage was to perform maintenance necessary to ready the unit for summer operation as well as to install emission control equipment necessary to substantially reduce NOx emissions. Despite the fact that the maintenance outage had been scheduled and approved in advance with the ISO, as the actual date of the outage approached, the ISO began to give indications that it did not intend to allow Reliant to proceed with the outage.

Because this unit had been operated at extremely high levels during the months preceding the scheduled outage, there were a number of operating problems with the unit that threatened to cause a potentially catastrophic failure of the unit. These included an economizer tube leak that was getting progressively worse. Reliant informed the ISO of these conditions and of Reliant's concern that continued operation of the unit was going to ultimately result in a forced outage. Reliant also informed the ISO that delaying this outage would have several negative implications. Attached is a chart depicting the differences between the proposed ISO maintenance schedule and the originally approved ISO maintenance schedule. Additionally, work crews had already been arranged to conduct the outage since the outage was being done in parallel with a similar outage that was already underway on Etiwanda Unit 4.

The compliant proceeding was filed to seek a determination regarding whether, under these circumstances, the ISO was entitled to reschedule this maintenance outage without regard for the cost, reliability and other implications associated with such actions. The attempted actions taken by the ISO seemed to be motivated more by short term considerations rather than considerations regarding the long term stability of the system over the upcoming summer.

The maintenance outage on Etiwanda Unit 3 is proceeding and the unit is expected to be back online prior to the peak summer season.

Pacific Gas and Electric Company

Dede Hapner
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June 4, 2001

The Honorable Dan Burton
Chairman, Committee on Government Reform
United States House of Representatives
Washington, DC 20515

The Honorable Doug Ose
Chairman, Subcommittee on Energy Policy,
Natural Resources, and Regulatory Affairs
United States House of Representatives
Washington, DC 20515

Dear Chairmen Burton and Ose:

In response to your letter of May 16, 2001, Pacific Gas and Electric Company is pleased to provide responses to your questions in follow-up to the Government Reform Committee's field hearings in San Jose, California of April 11, 2001.

Thank you for the opportunity to testify. We appreciate your personal efforts and that of the Committee to investigate and help arrive at solutions to the energy crisis now encompassing the state of California and the west. We are committed to continue working with you in any way possible to find such solutions.

Again, thank you for the opportunity to testify. Please let us know if we can provide any additional information.

Sincerely,

Dede Hapner

cc: Members, House Committee on Government Reform
The Honorable Mary Bono
The Honorable Lois Capps
The Honorable Christopher Cox
The Honorable Anna Eshoo
The Honorable Jane Harman
The Honorable Mike Honda
The Honorable Barbara Lee
The Honorable Zoe Lofgren
The Honorable George Radanovich

Transfers to Parent Corporation

Q1. What was PG&E's net income and return on assets in 1999 and 2000?

Pacific Gas and Electric Company

Year	Net Income (Loss) $ millions	Return on Assets
1999	$ 788	6.22%
2000	($ 3,483)	(13.18%)

Q2. What was PG&E's net income and return on assets for the first three months of 2001?

Pacific Gas and Electric Company

Year	Net Income (Loss) $ millions	Return on Assets
2001, 1st Quarter	($ 944)	(3.6%)

If first quarter returns are annualized, the return on assets would be a loss of approximately 14.3%.

Q3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

The following table provides ten years of the requested data:

Pacific Gas and Electric Company

Year	Net Income (Loss) $ millions	Return on Assets
1991	$ 1,026	8.06%
1992	$ 1,170	8.31%
1993	$ 1,065	7.15%
1994	$ 1,007	6.32%
1995	$ 1,338	7.43%
1996	$ 755	5.26%
1997	$ 768	5.22%
1998	$ 729	5.61%
1999	$ 788	6.22%
2000	($ 3,483)	(13.18%)

Q4. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 1999 and 2000.

The requested information is provided in the following table. Although there were no special dividends paid during this period, the table provides data for stock repurchases, which are included in this response for completeness.

Pacific Gas and Electric Company
Transfers to PG&E Corporation
($ millions)

Year	Dividends	Stock Repurchases	Income Taxes
1999	$ 415	$ 275	$ 1,000
2000	$ 475	$ 275	$ 0

In 1997, PG&E Corporation, a holding company for the regulated utility and unregulated subsidiary businesses, was formed. Prior to this time, Pacific Gas and Electric Company would pay dividends and income taxes directly to the shareholders or governmental entities. Since the formation of the holding company, the utility (as well as the subsidiary companies) calculates dividends and income taxes as if it were an independent company, but transfers these obligations to the holding company, which in turn pays dividends to shareholders or files consolidated income tax returns. Also, due to capital recovered from the sale of the utility's generation assets and in order to maintain a balanced capital structure and comply with California Public Utility Commission (CPUC) policy, PG&E Corporation repurchased some of its stock. In addition to the numbers above, there were also smaller transfers of funds between the utility and corporate parent that were reimbursements for administrative services provided by the corporation on behalf of the utility.

All interactions between the utility and the holding company are governed by regulations issued by the CPUC. Moreover, since the formation of PG&E Corporation, CPUC-ordered audits have found Pacific Gas and Electric Company to be in compliance and have issued no penalties. Finally, the CPUC and consumer advocates have reviewed Pacific Gas and Electric's financial policies and transactions annually in rate of return proceedings and have not disputed their propriety.

Q5. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 2001 prior to declaring bankruptcy.

There were no dividends, stock repurchases, special dividends, or income taxes paid from Pacific Gas and Electric Company to PG&E Corporation in the first quarter of 2001.

Additional Response to Hearing Question:

At the San Jose hearing on April 11, 2001, Congresswoman Barbara Lee asked some questions about the impact of the Chapter 11 bankruptcy filing on Pacific Gas and Electric's employees and retirees. To provide further information on those questions, included as "Attachment A," is a copy of an e-mail from the utility's vice president-human resources that was sent to all company officers, directors and department heads to be shared with their respective employees. The message provides information on employee compensation, benefits, retirement plan and other employee-related issues. PG&E's bankruptcy has no impact on our retirees' rights to receive benefits from our qualified pension plan.

Long-term contracts

Q1. Please describe in detail the terms and conditions of long-term contract proposals received by PG&E in the summer 2000.

Following the CPUC's August 3, 2000, decision allowing the utilities to enter into bilateral contracts, Pacific Gas and Electric Company issued a request for offers (RFO) in September, with bids to be accepted on October 11, 2000. PG&E requested bidders to provide energy offers for up to five years. PG&E accepted final bids on October 11, 2000, and awarded and executed bilateral contracts that same day.

The terms and conditions of firm long-term offers received by PG&E covered only the flat (power delivered at a constant rate 24-hours a day) and on-peak (power delivered from 7:00 a.m. to 10:00 pm) power delivery. Terms ranged from one year to five years, and prices ranged from $40.25/MWh to $94/MWh.

Bilateral contracts

Q1. Please provide in detail the terms and conditions of the bilateral contracts into which PG&E entered following the CPUC August 3 order. Please provide the Committee copies of those contracts.

All contracts contain explicit provisions for Pacific Gas and Electric Company to maintain confidentiality of the bidders, as well as the specific terms and conditions of the contracts. For this reason, PG&E can provide only the most general information about the contracts.

PG&E executed long-term contracts for 900 MW for flat and on-peak firm power. Contract terms ranged from 2.5 to 5 years. Prices for all contracts were below $66/MWh.

Q2. Is your contention that you were prevented from entering into long-term contracts by the CPUC failure to pre-approve contracts contradicted by the fact that PG&E did enter into some contracts following the August 3 order?

Pacific Gas and Electric Company was not prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts. However, the CPUC's August 3, 2000, decision required PG&E to do so under criteria that had been agreed to in advance between PG&E and CPUC staff. The staff's refusal to agree to appropriate pricing benchmarks pursuant to the CPUC's August 3 decision, and the CPUC's own subsequent refusal to approve criteria submitted by PG&E in an attempt to bypass the staff's inaction on this issue, significantly hindered PG&E from rapidly moving forward and contracting for bilateral contracts.

Without approved criteria, PG&E was placed into an untenable situation of either not moving ahead with bilateral contracts to provide price stability for its customers and to hedge against future price spikes, or to move forward and face potentially significant reasonableness risk for up to five years. PG&E believes its bilateral contracts are reasonable and should be deemed so by the CPUC under a reasonableness review, but PG&E has little confidence of receiving fair treatment in a potentially politicized environment created by the energy crisis and the enormous undercollection accrued by PG&E from May 2000 through January 15, 2001. PG&E's decision to eventually execute some bilateral contracts without CPUC-approved reasonableness standards was based on its belief that it was the right thing to do despite the potential monetary risk entailed in so doing.

PG&E had been diligently working with CPUC staff from August 2000 and continued to work with CPUC staff to try to reach agreement on reasonableness standards before executing contracts on October 11, 2000. At best, PG&E has received mixed signals from CPUC staff and the Commissioners themselves, with expressed opinions including: (a) PG&E should not enter into any long-term contracts, (b) the CPUC believes that after-the-fact reasonableness reviews are appropriate for these contracts, despite the clear wording of the August 3 decision, and (c) long-term contracts make sense and should be reasonable. This range of oral opinions, coupled with the CPUC's unwillingness to state criteria officially to guide the contracting process, made it extremely difficult for PG&E to proceed down any path with certainty.

Nonetheless, given the magnitude of the exposure to price volatility, PG&E believed that it was imperative to enter into bilateral contracts without further delay. As of October 11, 2000, the CPUC staff still declined to endorse PG&E moving forward with its bilateral contract solicitation, was unable to find that PG&E's proposed methodology for identifying an appropriate price benchmark was reasonable, and offered no suggestions or alternatives.

Even after the solicitation results were shared with CPUC staff, the staff was not willing to agree to any reasonableness standards. PG&E continued to seek CPUC clarification regarding bilateral purchase reasonableness standards and was prepared to enter into additional long-term contracts. However, prices for five year contracts began to exceed \$100/MWh later in the year, which, given the probability that the energy crisis would abate over time, posed significant reasonableness risk for the out years in the contracts given the absence of any clear reasonableness standards by the CPUC. That is, without the protection of reasonableness criteria that PG&E could meet in the marketplace, lower energy prices in the later years of a five-year contract would simply permit the CPUC to disallow substantial amounts of the contract costs based on after-the-fact reasonableness reviews that disregard the market dynamics at the time. PG&E was unwilling to accept that greater financial risk and did not enter into contracts at these higher prices. In addition, PG&E's financial condition had deteriorated by mid-December to the point that credit terms for long-term bilateral contracts were impossible for PG&E to meet.

Q3. What is your interpretation of the CPUC's "reasonableness" standards?

To this date, the CPUC has not adopted any reasonableness standards for bilateral contracts. In the absence of such standards, Pacific Gas and Electric Company believes it likely will face an after-the-fact review by the CPUC of the contracts that is based on the then-prevailing environment, rather than a fair review of the market conditions at the time the contracts were entered.

Prior to its August 3 decision, the CPUC conducted reasonableness reviews after-the-fact, often a year or more after the end of an operating year. These reviews did not follow preset standards, but rather were open-ended proceedings based on what the CPUC concluded, with hindsight and in the context of current conditions, that PG&E should have done. Such reasonableness reviews would create unacceptably large cost recovery risk for PG&E during periods of significant market change, such as have characterized the energy crisis in California since last summer.

The August 3 order approved PG&E's proposal for <u>prospective</u> reasonableness standards. The order said:

> [W]e find the proposed reasonableness standards of PG&E acceptable for near and interim purchases subject to the quantity restrictions previously adopted. Under PG&E's proposed standard, PG&E will identify for the Energy Division and the Office of Ratepayer Advocates, ahead of time the specific sources of prices offered in the market for energy, ancillary services and capacity products that will be used to price the bilateral transactions. These identified sources will provide a target price range for PG&E's contracts. Any purchases made by PG&E within this approved range will be reasonable per se. In addition, as PG&E enters into new bilateral purchases, PG&E will similarly identify a price range for the specific products being procured. The Energy Division and ORA will be able to validate the price range based on the same market price sources identified ahead of time.

To expedite approval of prospective reasonableness standards, on October 16, 2000, PG&E proposed specific reasonableness standards before entering into additional bilateral contracts. Unfortunately, the CPUC has failed to act on this filing.

Confusing the issue even further, the CPUC has since sought to modify its August 3 order. On December 22, 2000, the CPUC requested comments on proposed clarifications and modifications to the reasonableness standards of the August 3 order. Those standards would find any contracts up to years in duration to be reasonable if prices were between \$50-60/MWh. This price cap on reasonableness was issued by the Commission during a period when five-year contracts exceeded \$100/MWh, making it impossible for PG&E to enter into any such contracts without the significant financial exposure represented by the \$40-50/MWh differential.

On January 18, 2001, the CPUC proposed: a) another set of standards; and b) a new set of "portfolio benchmarks." PG&E expressed concerns that these proposals were unworkable in written comments filed with the CPUC. In conclusion, it is difficult for PG&E to predict how the CPUC will interpret its own August 3 approval of reasonableness standards for bilateral contracts, and, in any case, the CPUC has yet to provide any such guidance.

Q4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

The CPUC's failure to provide clear and useful reasonableness standards created uncertainty about the recovery of forward purchase costs, and hindered PG&E from entering into long-term purchases earlier and for larger contract amounts.

<u>Stranded Costs</u>

Q1. Does PG&E consider the TURN Proposal a more appropriate standard?

No, Pacific Gas and Electric Company considers the TURN Proposal to be an illegal change to the rules of the transition period after PG&E had already recovered its transition costs and contrary to provisions of AB 1890. By way of background, when the restructuring law was implemented the CPUC established two accounts for the utilities to track revenue collection during the transition to a competitive market. The Transition Cost Balancing Account (TCBA) is used to track the recovery of utilities' stranded costs and the Transition Revenue Account (TRA) is used to match the amount of the billed revenues against various costs associated with providing service including transmission, distribution, generation and public purpose charges.

Until the TURN Proposal was adopted, the balance in the TRA was transferred to the TCBA at the end of each month. The Commission ruled in 1998 that only positive balances were to be transferred, reasoning that if negative balances were allowed into the TCBA, effectively they would become transition costs, eligible for stranded cost recovery, inconsistent with provisions of AB 1890. During the first years of the transition, when utilities had excess revenues, they used them to write down the transition costs. Once a transition cost was written down, it could not reappear on the books. If the utilities did not have excess revenue one month, no transitions costs were paid that month; the amount of transition costs to be collected was not increased.

The TURN Proposal changed the Commission's 1998 decision and would allow negative balances to be transferred from the TRA to the TCBA, essentially increasing the transition costs to be recovered. The effect of the accounting change is to make it appear as if PG&E has not recovered its transition costs. During hearings on the proposal, TURN's witness stated that "under the TURN accounting proposal, there are NO (zero) unrecovered purchase power costs; only unrecovered transition costs." In fact, the Commission itself acknowledged this effect, saying the utilities "have not recovered all of their stranded costs under any scenario put forth by any party, given these accounting adjustments [*i.e.*, the adoption of the TURN accounting proposal, which completely reverses the rules for measuring transition cost recovery]."[1/]

Q2. Some have argued that the accounting change is a regulatory taking of assets. What are the views of PG&E on this subject?

Pacific Gas and Electric Company agrees that the TURN Proposal results in an unconstitutional taking of PG&E's assets.

The accounting change in the TURN Proposal makes it appear that PG&E has not recovered its transition costs. Under AB 1890, the rate freeze stays in effect until transition costs are recovered or until March 31, 2002, whichever occurs earlier. Because the accounting changes make it impossible for PG&E to recover its transition costs, frozen rate levels keep rates that are clearly below the authorized cost of service. The United States Supreme Court has ruled that rates must be set at a level that allows the utility a reasonable opportunity to recover its costs of service. If the rate does not afford sufficient compensation, the state has taken the use of the utility property without paying just compensation and so violates the Fifth and Fourteenth Amendments of the U.S. Constitution.

Rewriting the accounting rules after the fact makes it appear that PG&E has recovered procurement costs and failed to recover transition costs. This is significant because under the federal Filed Rate Doctrine the CPUC is required to allow PG&E to recover from ratepayers federally approved wholesale power costs. By offsetting the procurement costs against the transition costs, the CPUC is attempting to preclude PG&E from recovering its procurement costs. This results in a taking of PG&E's property without just compensation.

Further, the TURN Proposal's effect is to require PG&E to forgo its already collected transition costs to pay for power procurement costs. Because there is no apparent means of recovering the costs transferred into the TCBA, a taking has clearly occurred.

1/ Accounting Reversal Decision, mimeo at p. 20.

Q3. How does the TURN Proposal affect the Transitional Recovery Account (sic) and the Transition Cost Balancing Account?

As described above, prior to the Commission's adoption of the TURN Proposal, any revenues accrued in the Transition Revenue Account (TRA) were transferred monthly to the Transition Cost Balancing Account (TCBA), but negative balances were not allowed to be transferred from the TRA to the TCBA. Previously, any revenues in the Generation Memorandum Accounts (set up to track the ongoing costs for the utilities' retained generation and market revenues from sales from those plants into the power exchange) were also transferred to the TCBA to offset transition costs.

The TURN Proposal changes CPUC accounting rules so that uncollected costs in the TRA are transferred monthly into the TCBA. In addition, above market generation revenues accumulated in the Generation Memorandum Accounts are transferred to the TRA instead of the TCBA. The effect of this change in the accounting rules is that (1) the growing deficit in the TRA due to the high costs of procuring power on behalf of our customers depletes the revenue already collected to recover transition costs, and (2) procurement costs are converted into transition costs that have no chance of recovery by the statutory end of the transition period (i.e., March 31, 2002).

Q4. With this new accounting procedure, will PG&E be able to collect against its stranded costs as envisioned in AB 1890.

The TURN Proposal makes it unlikely, if not impossible, that Pacific Gas and Electric Company could fully recover its stranded costs, absent a favorable outcome to PG&E's various legal challenges to the CPUC's prior interpretations of AB 1890. The only source of recovery of transition costs remaining (after the elimination of headroom given the current level of power costs, and the CPUC's actions transferring revenues derived from sales of generation at market rates from being used to pay down transition costs to, instead, paying down procurement costs) would be from the market valuation of utility retained generation, as required by AB 1890. However, it is unlikely that the aggregate market value of PG&E's retained non-nuclear assets would exceed the outstanding uncollected stranded costs.

FERC's Market Mitigation Plan

Q1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

FERC's plan imposes price mitigation for real-time sales during emergency periods of reserve deficiency (i.e., when generation reserves are 7.5 percent or less). While this approach may partially limit prices and represents a good first step toward mitigation, it will not ensure just and reasonable rates generally unless it is modified to: (1) apply to all hours, not just emergency conditions, (2) address and restrain prices in the forward market, and (3) use reasonable inputs for determining proxy prices rather than relying on the least efficient generator, gas purchased only in the spot market, and high priced emission credits. Also, as discussed in Question 4 below, the plan should apply to the entire market, in this case the entire Western States Coordinating Council (WSCC) region.

Q2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

The extent of any blackouts in California this summer is dependent on a number of factors, including temperature and rainfall, which cannot be fully known ahead of time. However, the fundamental problem leading to blackouts -- the current imbalance between supply and demand -- can only be resolved on a long-term basis and is currently being addressed in a number of forums (e.g., streamlining of siting approvals, energy efficiency and demand reduction program designs, financial incentives for transmission upgrades).

FERC's mitigation plan takes certain steps to address this supply and demand imbalance through must-sell requirements, encouraging demand response, and the coordination and control of generation outages. However, in the short term, these measures will make only a minor contribution to the supply insufficiency, and until significant additional generation capacity is brought online, FERC must focus on protecting consumers against prices that exceed just and reasonable levels.

Q3. Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?

FERC's plan requires that all in-state generators offer available capacity to the California ISO in real time. With respect to the WSCC, the plan merely proposes that all available capacity be offered for sale in real time anywhere in the West. Under either approach, out-of-state generators are free to choose where to sell their real-time power, and they clearly will not choose markets where they are financially disadvantaged in some way. Thus, to the extent that only California sales are subject to price mitigation (as is currently the case), FERC's plan could discourage out-of-state generators from selling into California.

If mitigation is applied comprehensively across the West, such a plan would not discourage sales into California.

Q4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Market mitigation can be effective only if it encompasses the entire affected market. The Western grid is fully interconnected, and the region has a long history of wholesale power exchanges and mutual reliance. Right now, the entire Western region of the United States is facing a serious shortage of electricity supplies at the same time that demand for power has increased significantly. Various circumstances including unanticipated load growth, weather conditions, and low water reserves for hydroelectric generation have led to capacity concerns throughout the WSCC region. Moreover, the high level of energy trades across state boundaries in the West causes market imperfections to be felt across state boundaries as well. As a result, prices for this essential commodity are so high that the economic and social well being of the entire region is threatened. A regional mitigation plan can address the interconnected nature of the Western electricity market and prevent buyers from bidding up energy prices as they seek to meet inelastic demand and avoid curtailing their customers.

Q1. Do you believe that municipalities and PMA's will have to abide by the market mitigation plan?

A problem arises with requiring these entities to abide by the mitigation plan because they are not directly subject to FERC's jurisdiction. Nevertheless, FERC makes creative use of its limited existing jurisdiction to compel compliance. FERC requires that, "as a condition of using the ISO's open access interstate transmission tariff which is subject to this Commission's exclusive jurisdiction, all sellers of energy that own or control generators in California, including non-public utilities, whose power is transmitted over the ISO-controlled interstate transmission facilities, must abide by the same must-offer obligation and the price mitigation plan" as jurisdictional entities. While many municipalities can be expected to challenge this use of FERC's jurisdiction, FERC previously has adopted reciprocity requirements as part of its open access policies, and the market mitigation conditions can be viewed, generally, as extension of this policy.

PG&E would note that this problem could be addressed by legislation that gives FERC the necessary jurisdiction over these entities.

Q2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

FERC allows marketers to either accept the market clearing proxy price or submit their own bid. If their bid exceeds the market clearing price, they would be required to justify the bid based on the prices they paid for power. As the Commission recognized, marketers generally have portfolios of energy supplies, which may have been acquired from other marketers, so that the same megawatt has been sold many times. Thus, marketers have the ability to buy power either in the day-ahead market or in longer-term forward contracts and then resell such power to other marketers who, in turn, can sell to yet another marketer. Such multiple sale transactions can increase prices exponentially because each transaction provides the opportunity for significant mark-ups.

Q3. Will the plan protect consumers from megawatt laundering?

The current plan provides no substantive response to this problem. "Megawatt laundering" refers to the practice where an in-state supplier schedules supply out-of-state and then reimports that power to avoid a mitigated price. Several commenters voiced concern about this practice in FERC's proceeding. In response, the Commission instituted an investigation into public utility sales for resale in the WSCC.

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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May 16, 2001

Ms. Dede Hapner
Vice President of Regulatory Relations
Pacific Gas and Electric Company
700 11th Street, NW, Suite 250
Washington, D.C. 20001

Dear Ms. Hapner:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 11 in San Jose. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Transfers to Parent Corporations:

At the April 11 hearing, several Members requested that Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) provide information on profits generated and funds transferred to parent companies. For instance, Congresswoman Lofgren asked:

> *"I am wondering if I could ask you, Ms. Hapner, -- and my constituents talk to me about this all the time -- how much was transferred from PG&E to its parent corporation, what is the dollar figure?"*

You responded by stating:

> *"I do not have the exact amount, I would just reiterate that all actions that we took were in compliance with the Commission rules. I will get you that exact amount."*

In his testimony, Steven Pickett of SCE testified that there are three categories of allowable transfers from regulated utilities to their parent companies: 1.) dividends of earnings 2.) payments of taxes and 3.) special dividends.

Please respond to the following questions:

1. What was PG&E's net income and return on assets in 1999 and 2000?

2. What was PG&E's net income and return on assets for the first three months of 2001?

3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

4. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 1999 and 2000.

5. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 2001 prior to declaring bankruptcy.

Long-Term Contracts:

There have been numerous press reports that the investor-owned utilities in California received offers of long-term contracts at five cents per kilowatt hour in the summer of 2000. On April 11, you were asked if PG&E had received such offers during that time period. You responded:

> *"When we investigated those offers, they were not what they appeared to be and what were covered in the media. ... They were considerably higher than five cents, particularly for peak periods."*

Please respond to the following question:

1. Please describe in detail the terms and conditions of the long-term contract proposals received by PG&E in the summer of 2000.

Bilateral Contracts

At both the April 10 and April 11 hearings, there was a great deal of discussion about the California Public Utilities Commission's August 3, 2000, order allowing regulated utilities to enter into bilateral contracts. The discussion centered around whether that order granted the utilities sufficient authority to lock in relatively low long-term rates before the market exploded.

Ms. Dede Hapner
Page 3

On April 10, CPUC President Loretta Lynch testified that:

"On a unanimous vote two weeks after the utilities asked for the authority to enter into bilateral contracts, the PUC did give the utilities the authority to enter into bilateral contracts, and then they entered into bilateral contracts. I am prevented, for confidentiality reasons, from telling the public exactly what they entered into, but I can tell you they entered into significant bilateral contracts."

On April 11, you stated that PG&E did in fact sign some bilateral contracts following the CPUC's August 3 order:

"We finally went out at our own risk, and we still do not have reasonableness protection, but we actually went out at our own risk and signed a series of contracts, several of them at about 5.5 cents."

While you did not at the time have the details of those contracts, you offered to provide them to the Committee. Please respond to the following questions and requests for information:

1. Please describe in detail the terms and conditions of the bilateral contracts into which PG&E entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.

2. Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that PG&E did in fact enter into some contracts following the August 3 order?

3. What is your interpretation of the CPUC's "reasonableness" standards?

4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

Stranded Costs

The CPUC recently changed certain regulatory accounting principles for the investor-owned utilities that were agreed upon in 1998. This change has been referred to as the "TURN Proposal." Please respond to the following questions:

1. Does PG&E consider the TURN Proposal a more appropriate standard?

2. Some have argued that the accounting change is a regulatory taking of assets. What are the views of PG&E on this subject?

3. How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?

4. With this new accounting procedure, will PG&E be able to collect against its stranded costs as envisioned in AB 1890?

FERC's Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Ms. Dede Hapner
Page 5

Thank you for your continued cooperation in this matter. In order to allow us to complete the hearing record in a timely fashion, please respond by Friday, May 25. If you have any questions please contact Full Committee Staff Director Kevin Binger at 202-225-5074.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

Cc: The Honorable Henry Waxman
Ranking Minority Member

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM
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May 16, 2001

Mr. Stephen Pickett
Vice President and General Counsel
Southern California Edison
2244 Walnut Grove Avenue
Rosemead, CA 91770

Dear Mr. Pickett:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 11 in San Jose. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Transfers to Parent Corporations:

At the April 11 hearing, several Members requested that Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) provide information on profits generated and funds transferred to parent companies. For instance, Congresswoman Lofgren asked:

> *"Does Southern California Edison have a parent corporation? ... And were there transfers of funds to the parent corporation from you all as well?"*

You responded in the affirmative, and stated:

> *"I do not know the dollar amount off the top of my head. We can get it and supply it to the Committee."*

You added that there are three categories of allowable transfers from regulated utilities to their parent companies: 1.) dividends of earnings 2.) payments of taxes and 3.) special dividends.

Mr. Stephen Pickett
Page 2

Please respond to the following questions:

1. What was SCE's net income and return on assets in 1999 and 2000?

2. What was SCE's net income and return on assets for the first three months of 2001?

3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

4. For each of the three categories of allowable transfers listed above, please specify how much money SCE transferred to its parent company in 1999 and 2000.

5. For each of the three categories of allowable transfers listed above, please specify how much money SCE has transferred to its parent company during the first three months of 2001.

Long-Term Contracts:

There have been numerous press reports that the investor-owned utilities in California received offers of long-term contracts at five cents per kilowatt hour in the summer of 2000. On April 11, you were asked if SCE had received such offers during that time period, and what rates were offered. You responded:

> *"I do not have the exact number. We can get the numbers that were made available to us and present them to you, if it is of benefit to the Committee. We found, as PG&E apparently did, that a number of generators made offers, usually through the press, not directly to us, that they were willing to sell us power, a figure that was tossed around in the early or late spring, early summer of last year was five cent power."*

You added:

> *"It proved, on investigation, not to be the fact. The terms of the contracts would have ultimately made them substantially more expensive."*

Please respond to the following question:

1. Please describe in detail the terms and conditions of the long-term contract proposals received by SCE in the summer of 2000.

Bilateral Contracts

At both the April 10 and April 11 hearings, there was a great deal of discussion about the California Public Utilities Commission's August 3, 2000, order allowing regulated utilities to enter into bilateral contracts. The discussion centered around whether that order granted the utilities sufficient authority to lock in relatively low long-term rates before the market exploded.

On April 10, CPUC President Loretta Lynch testified that:

> *"On a unanimous vote two weeks after the utilities asked for the authority to enter into bilateral contracts, the PUC did give the utilities the authority to enter into bilateral contracts, and then they entered into bilateral contracts. I am prevented, for confidentiality reasons, from telling the public exactly what they entered into, but I can tell you they entered into significant bilateral contracts."*

On April 11, you stated that SCE did in fact sign five bilateral contracts totalling 350 megawatts of power following the CPUC's August 3 order. While you did not at the time have the details of those contracts, you offered to provide them to the Committee. Please respond to the following questions and requests for information:

1. Please describe in detail the terms and conditions of the bilateral contracts into which SCE entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.

2. Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that SCE did in fact enter into some contracts following the August 3 order?

3. What is your interpretation of the CPUC's "reasonableness" standards?

4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

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Mr. Stephen Pickett
Page 5

Thank you for your continued cooperation in this matter. In order to allow us to complete the hearing record in a timely fashion, please respond by Friday, May 25. If you have any questions, please contact Full Committee Staff Director Kevin Binger at 202-225-5074.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

Cc: The Honorable Henry Waxman
Ranking Minority Member

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Stephen E. Pickett
Vice President &
General Counsel

May 25, 2001

The Honorable Dan Burton, Chairman
House Committee on Government Reform
United States House of Representatives
Washington D.C. 20510

The Honorable Doug Ose, Chairman
Subcommittee on Energy Policy, Natural Resources
and Regulatory Affairs
United States House of Representatives
Washington D.C. 20510

{Via Facsimile and U.S. Mail}

RE: Committee Questions

Dear Chairmen Burton and Ose:

Southern California Edison (SCE) was pleased to provide testimony to the House Committee on Government Reform on April 11, 2001, in San Jose, California. We appreciate this opportunity to provide the Committee with additional details concerning our financial situation, the Federal Energy Regulatory Commission's (FERC) Market Mitigation Plan, power contracting opportunities, and stranded costs.

SCE has provided answers to as many of the Committee's questions as possible prior to your May 25, 2001, deadline. SCE respectfully requests until June 8, 2001, to provide the remaining answers. The Committee's questions are re-stated below in *italics* with my answers directly below each question.

Transfers of Funds to the Parent Corporation

1) *What was SCE's net income and return on assets in 1999 and 2000?*

	1999:	2000:
Net Income	$ 509,421,000	($ 2,028,344,000)
Total Assets	$17,657,306,000	$15,966,096,000
Return on Assets	2.89%	(12.70%)

The net income was calculated before payment of dividends on preferred stock. Total assets are as reported on SCE's consolidated balance sheet and include items not included in utility rate base, i.e., items not charged to our customers in the electric rates they pay SCE. Return on assets is net income divided by total assets.

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The Honorable Dan Burton and Doug Ose
United States House of Representatives
May 25, 2001
Page 2 of 3

2) *What was SCE's net income and return on assets for the first three (3) months of 2001?*

	<u>2001</u>:
Net Income	($592,000,000)
Total Assets	$17,879,000,000
Return on Assets	(13.24%) (Annualized)

3) *How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?*

SCE assumes this question is intended to state "SCE" rather than "PG&E". As such, included below for comparison to Questions 1 and 2 are SCE's net income and return on asset figures for the years 1993 – 1997. SCE assumes "deregulation" began in 1998, when the Power Exchange and the Independent System Operator began operations.

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
Net Income	$678	$639	$680	$655	$606
Total Assets	$18,098	$18,076	$18,155	$17,737	$18,059
Return on Assets	3.75%	3.54%	3.75%	3.69%	3.36%

4) *For each of the three (3) categories of allowable transfers [dividends of earnings, payment of taxes, and special dividends], please specify how much money SCE transferred to its parent company in 1999 and 2000.*

A total of $1.8 Billion was transferred from SCE to its parent company, Edison International (EIX), during 1999 and 2000. These monies were used to pay dividends to EIX's shareholders, to pay taxes, to repurchase shares of EIX common stock, and to pay certain miscellaneous expenses. The transfers are discussed by class below:

- <u>Dividends paid to common shareholders</u>: SCE pays dividends to EIX (its only shareholder) that are used to fund EIX common shareholder dividends. For 1999 and 2000, the dividends transferred by SCE to EIX were:
  - <u>1999</u>: $372,749,215
  - <u>2000</u>: $371,411,105
- <u>Taxes</u>: In accordance with Internal Revenue Code provisions based on SCE's "stand alone" taxable income and pursuant to CPUC Decision #84-05-036 (OII 24), SCE computed and paid its taxes on the "separate return method" to EIX totaling $753,808,206 in 1999 and 2000.
  - <u>1999</u>: $431,155,157
  - <u>2000</u>: $322,653,049

The Honorable Dan Burton and Doug Ose
United States House of Representatives
May 25, 2001
Page 3 of 3

- Special Dividends: SCE dividends to EIX in excess of those used to pay common dividends are identified below as special dividends. In 1999 and 2000, these funds stemmed from ongoing transition cost recovery of shareholders' investments in SCE's generation assets. The funds were used to repurchase EIX shares of common stock in the open market. Share repurchase is a cost-effective way to reduce a company's capitalization in response to a shrinking asset base. Special dividends in 1999 and 2000 were:
  - 1999: $290,533,091
  - 2000: $ 857,000

- Other Transfers: In addition to those identified in my April 11, 2001, testimony other miscellaneous transfers from SCE to EIX occurred during 1999 and 2000. These transfers include various items including amounts for reimbursement of expenses paid directly by EIX and the payment of employee payroll deductions that were withheld from EIX employees[1/].
  - 1999: $ 5,867,745
  - 2000: $11,225,247

5) *For each of the three (3) categories of allowable transfers [dividends of earnings, payment of taxes, and special dividends], please specify how much money SCE transferred to its parent company during the first three months of 2001.*

For the First Quarter of 2001, SCE has ***not*** paid any dividends, taxes or special dividends to EIX.

As previously stated, SCE will provide answers to the Sections entitled "Long Term Contracts," "Bilateral Contracts," "Stranded Costs" and "FERC's Market Mitigation Plan" on June 8, 2001. We appreciate the Committee's patience and interest in this matter. If I can provide any additional information, please contact me at (626) 302-1903.

Sincerely,

Stephen E. Pickett

Stephen E. Pickett
Vice President and General Counsel
Southern California Edison

cc: The Honorable Henry Waxman, Ranking Minority Member
House Committee on Government Reform

1/ Specifically, the transfers here include the payments for payroll deductions; and reimbursements for insurance premiums paid for by EIX; and reimbursements for over funded payroll advances.

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FAX TRANSMITTAL SHEET

DATE: **May 25, 2001**

TO: **The Honorable Dan Burton FAX NO.: 202-225-3974**
C/O Kevin Binger

FROM: **Stephen E. Pickett**

TOTAL PAGES (including cover sheet): **(4)**

SUBJECT: **Committee Questions**
House Committee on Government Reform

Please call (626) 302-2-3417 should you have problems with the transmittal of this facsimile.

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Stephen E. Pickett
Vice President &
General Counsel

June 8, 2001

The Honorable Dan Burton, Chairman
House Committee on Government Reform
United States House of Representatives
Washington, D.C. 20215

The Honorable Doug Ose, Chairman
Subcommittee on Energy Policy, Natural Resources
and Regulatory Affairs
United States House of Representatives
Washington, D.C. 20215

{Via Facsimile and U.S. Mail}

RE: Committee Questions

Dear Chairmen Burton and Ose:

As a follow-up to my May 25, 2001, letter Southern California Edison (SCE) is pleased to provide the House Committee on Government Reform with the answers to the remaining questions posed on May 16, 2001. We appreciate the Committee's patience on this matter.

The Committee's questions are re-stated below in *italics* with SCE's answers directly below each question.

Long Term Contracts

1) *Please describe in detail the terms and conditions of the long-term contract proposals received by SCE in the summer of 2000.*

Prior to August 3, 2000, SCE had no authority from the California Public Utilities Commission (CPUC) to purchase power outside the California Power Exchange (CalPX). SCE's ability to purchase power in the CalPX markets was limited to the products offered by the CalPX and in other respects by the CPUC. These CPUC restrictions pertained to the duration, type, and quantity of CalPX contracts. For example, SCE never had authority from the CPUC to enter into contracts in the CalPX markets extending beyond March 31, 2002.

This question does not provide a definition of a "long-term contract." In the past, SCE has defined a long-term contract as a contract with a term greater than 5 years. According to this definition, SCE lacked the authority to enter into a long-term contract through the CalPX during the summer of 2000. As a practical matter, however, virtually all of the trading that did take place in CalPX forward markets was in products having delivery within the next 12 months. SCE would not consider such transactions to be "long-term."

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Prior to August 3, 2000, SCE received a few unsolicited contract proposals; however, because SCE lacked the authority to contract for power outside the CalPX prior to August 3, 2000, these proposals were not actionable. Accordingly, and because these offers were submitted with the expectation of confidential treatment, SCE is not including details about these offers in this letter.

On July 21, 2000, SCE filed an emergency motion to the CPUC for approval to enter into bilateral contracts (that is, contracts directly with individual power sellers and outside the CalPX). SCE had previously requested CPUC approval to enter into bilateral contracts in March 1999. The CPUC had denied this request in July 1999.

Acting on SCE's July 21, 2000, emergency motion, on August 3, 2000, the CPUC authorized SCE to purchase power up to certain quantity limits under bilateral contracts. Specifically, the CPUC's authorization allowed SCE to sign "near-term" bilateral contracts up to 2 years in duration (delivery through December 31, 2002) and solicit offers for "medium-term" bilateral contracts up to 5 years in duration (delivery through December 31, 2005). Offers for medium-term bilateral contracts were to be submitted for CPUC acceptance, and if pre-approved, could then be signed.

SCE's near-term bilateral contracts were subject to CPUC reasonableness review if a 5% "safe-harbor" tolerance band on average, annual price was exceeded. For medium-term bilateral contracts, the CPUC's August 3, 2001, order specified that the CPUC would act on SCE's request for contract pre-approval within 30 days. In August 2000, SCE solicited offers for medium-term bilateral contracts (Request For Offers or "RFO"). Responses to this solicitation were received in mid-September 2000. These offers were either "indicative" (non-binding) or expired in a matter of a few hours.

One of the conditions of the RFO is that all individual offers are confidential; however, please note that in the aggregate, SCE received offers for 1,275 megawatts (MW) of capacity contracts and 1,795 MW of firm energy contracts. For the standard 6X16 energy contract (delivery from Monday through Saturday, 6:00 a.m. to 10:00 p.m., excluding holidays), 5-year prices ranged from \$57/megawatt-hour (MWh) to \$65/MWh. For the 7X24 energy contract, 5-year prices (with the exception of one bid) ranged from \$51/MWh to \$55/MWh.

SCE submitted all offers received, as well as its analysis and ranking of offers and the procedure for refreshing and awarding expired bids, to the CPUC staff (the Energy Division) for pre-approval. SCE met with the Energy Division to review bids, explain its analysis and ranking, explain the procedure for refreshing and awarding bids, and answer all questions. Nevertheless, the CPUC failed to respond to SCE's request for pre-approval of contracts within 30 days (or to this date). Based on the CPUC's failure to act within 30 days, and allowing for additional discussions with CPUC commissioners and staff, SCE deemed that the submitted contracts were pre-approved. In November 2000, SCE refreshed and awarded bids for firm energy contracts.

Bilateral Contracts

1) *Please describe in detail the terms and conditions of the bilateral contracts into which SCE entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.*

SCE entered into 20 separate bilateral transactions with 6 separate counter-parties for the purchase of fixed-price firm energy. These transactions were both near- and medium-term bilateral contracts. Five medium-term (5-year) bilateral contracts for firm energy were entered into in mid-November 2000 and totaled 350 MW. These contracts were both 6X16 (on-peak delivery) and 7X24 (round-the-clock delivery). The remaining bilateral contracts were near-term (less than 2-years in duration). Eleven of the 20 transactions were terminated by the respective counter-party in mid-January 2001 due to cross-default provisions in the contracts and SCE's non-payment of certain indebtedness.

The terms and conditions of all the bilateral contracts are confidential. Due to the fact the contracts contain confidentiality clauses, copies are not enclosed with this letter.

2) *Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that SCE did in fact enter into some contracts following the August 3 order?*

No. As discussed above, SCE submitted contracts to the CPUC for pre-approval in mid-September 2000. The refusal of the CPUC to act on SCE's request delayed SCE's process of refreshing bids and signing contracts until mid-November 2000. In early December 2000, SCE requested that the CPUC promptly pre-approve capacity contracts. The CPUC failed to respond (to this date) to this request as well.

SCE's creditworthiness deteriorated in late December 2000 and early January 2001 to the point that suppliers would no longer contract to sell power to SCE. Accordingly, the CPUC's failure to promptly pre-approve SCE's contracts effectively prevented SCE from entering into contracts beyond those signed in mid-November 2000. Because the CPUC's August 3, 2000, order specified a 30-day process for reviewing contracts and acting on pre-approval requests (SCE had recommended a 10-day process), SCE believes that it was required to wait at least 30 days for the CPUC to complete its review. SCE was not authorized to enter into medium-term (5-year) contracts without submitting the contracts to the CPUC for pre-approval. Observing the CPUC's refusal to implement the pre-approval process, in December 2000 SCE requested CPUC approval to sign medium-term bilateral contracts without pre-approval, but subject to later reasonableness review. The CPUC's Office of Ratepayer Advocates (ORA) protested SCE's request, arguing that pre-approval of contracts was essential. The CPUC has not (to this date) ruled on SCE's request.

3) *What is your interpretation of the CPUC's "reasonableness" standards?*

It is clear from several CPUC decisions dating back to 1995 that the CPUC considered power purchases from the CalPX and the California Independent System Operator (CAISO) markets to be "per se" reasonable (a result of the CPUC's endorsements of these markets). As mentioned above, however, SCE was not authorized to enter into transactions outside the CalPX and CAISO until August 3, 2000. Beginning on that date, SCE was authorized to enter into medium-term (5-year) bilateral contracts that had been "pre-approved" by the CPUC. SCE believed that CPUC pre-approval of the contract meant that the CPUC considered the contract to be "reasonable."

Unfortunately, the CPUC's ORA believed that "pre-approval" only meant that the contract could be signed, not that it was reasonable. In a protest filed with the CPUC on September 1, 2000, ORA argued that pre-approved contracts should be reviewed for reasonableness at a later date. Recognizing that its protest could delay approval of the tariff change that would permit SCE to record the costs of its bilateral contracts for later recovery from retail customers, ORA asked for the CPUC to rule on its protest by September 21, 2000. Nevertheless, the CPUC did not act on ORA's protest until December 21, 2000, although it did rule in SCE's favor. The other category of bilateral contractsauthorized by the CPUC on August 3, 2000, was a near-term (2-year) contract. The CPUC decision provided that such contracts would be reviewed for reasonableness if the average price of these contracts exceeded a 5% safe-harbor band over an annual period; however, the CPUC did not specify the standards it would use to evaluate reasonableness of such contracts if the safe-harbor band was exceeded.

On December 21, 2000, the CPUC issued a decision proposing and seeking comments on procurement reasonableness standards. This decision stated that "[t]he proposal issued today is prompted largely by our concern that these three utilities may be underutilizing the price-moderating potential of bilateral forward purchases because of the risk of after-the-fact review of the purchases." The decision further stated "[w]e act today in response to Governor Gray Davis' request that we 'expeditiously develop benchmarks to assure the reasonableness of these contracts without unfairly 'second guessing' the utilities' purchase decisions in later years." In addition, this decision stated that the CPUC would consider a fixed-price, 5-year, 7X24 contract having a price of 6 cents per kilowatt-hour or less to be reasonable (provided the contract was not with an affiliated company). At the time, the market price for such a contract was nearly 50% higher than the price the CPUC considered to be reasonable. SCE expressed this concern as well as several other concerns in its comments on the proposed reasonableness standards. To date, the CPUC has not issued a decision adopting procurement reasonableness standards for the utilities.

4) *How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?*

The CPUC's failure to adopt practical procurement guidelines and reasonableness standards effectively precluded SCE from entering bilateral forward electricity procurement contracts at a time when prices were much lower than they have been in the recent past. Under the CPUC's rulings, SCE was unable to even solicit offers for bilateral contracts until August 2000. Even then, the offers were subject to a cumbersome and time-consuming approval process at the CPUC.

Some argue that SCE should have gone ahead and entered bilateral contracts without CPUC pre-approval. As described above, the CPUC's rulings prevented that until it was too late. Moreover, SCE makes no money on power procurement for its customers – wholesale power costs are (or are supposed to be) passed through to customers with no mark-up. Subsequent after-the-fact reasonableness reviews by the CPUC can only disallow recovery of costs on which SCE makes no profit whatever. In such an environment, with no clear CPUC guidelines on what constituted "reasonable" electricity procurement and with billions of potentially disallowable dollars at stake, SCE had no practical choice but to seek CPUC pre-approval of any bilateral electricity purchase contracts.

Stranded Costs

1) *Does SCE consider the TURN Proposal a more appropriate standard?*

SCE believes that the TURN Proposal constitutes illegal retroactive ratemaking and the CPUC's adoption of it was a mistake. The TURN Proposal requires SCE to transfer operating costs, now recorded in SCE's Transition Revenue Account (TRA), to SCE's Transition Cost Balancing Account (TCBA.) As explained in detail in SCE's responses to Questions 2 – 4 below, SCE presently has no means of recovering all of the costs now recorded in the TCBA, because some of the AB 1890-era revenue sources for recovering transition costs have been eliminated by recent California legislation and the dysfunctional market.

The TURN Proposal has the effect of: (1) transforming utility operating expenses for customer electricity procurement into unrecoverable competition transition costs; (2) potentially preventing SCE from recovering those costs; (3) violating the federal filed rate doctrine; and (4) violating the statutory mandate to end the rate freeze as expeditiously as possible. Because the CPUC unlawfully applied the TURN Proposal retroactively, it effectively left SCE with no means of recovering more than $3 billion, which is the net "undercollection" (SCE's excess costs for purchased power less the revenues from selling the output of its generation in the market.)[1]

2) *Some have argued that the accounting change is a regulatory taking of assets. What are the views of SCE on this subject?*

Although the TURN Proposal is often described as an "accounting change," it is far more significant. The TURN Proposal was intended to force SCE to write off legitimate power purchase costs after the end of the rate freeze. At present, the CPUC has provided no means of recovering the purchased power costs that SCE transfers to the TCBA. Thus, the TURN Proposal forces SCE to transfer the costs of purchasing power to the TCBA at a time when SCE has been deprived of the ability to recover the costs booked into the TCBA. As explained below, absent a ruling by the federal court, legislation or some action by the CPUC enabling SCE to recover those costs, the TURN Proposal will result in an unlawful confiscation of SCE's property.

Utility takings law is grounded in the principle that the property of a utility, although employed for the convenience of the public, belongs to the utility and cannot be taken from it without due process of law. Investors entrust capital to the utility in good faith, with the expectation that regulators will treat them fairly. "The basic principle of ratemaking is to establish a rate which will permit the utility to recover its costs and expenses *plus* a reasonable return on the value of property devoted to public use."[2] "If the rate does not afford sufficient compensation, the State has taken the use of the utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."[3]

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1 SCE believes that the U.S. District Court federal court will eventually recognize that SCE's power purchases are recoverable pursuant to the federal filed rate doctrine, or, alternatively, that the CPUC or the California Legislature will provide some mechanism for recovery.

2 Southern California Gas Co. v. PUC, 23 Cal. 3d 470, 476 (1979).

3 Duquesne Light Co. v. Barasch, 488 U.S. 299, 308 (1989). It also is contrary to AB 1890, which was designed neither to deprive SCE of recovery of its normal operating expenses nor to change the long-standing principle that a utility is entitled to recover its reasonable operating costs.

By ordering that SCE's TRA undercollection be transferred to the TCBA, the TURN Proposal may have the effect of preventing SCE from achieving the recovery of costs to which it is constitutionally entitled and thus effect a "taking." The reason is that at present there is a pileup of costs into the TCBA, which will not be recovered. California ABX1-6 forced SCE to retain its existing plants, and thus deprives it of the ability to offset transition costs with the proceeds of the sale of plants. ABX1-6 also requires SCE to use its retained generation for the benefit of the public, rather than selling its output into the market. This eliminated another important source of transition cost recovery, market energy revenues. TRA headroom, a third source of transition cost recovery, exists only so long as the California Department of Water Resources (CDWR) covers SCE's net short position. Requiring utilities to retain their remaining generation and sell the output to customers at cost-based rates is not necessarily illegal or a taking, but it assumes the essential *quid pro quo* of allowing the utility to recovery in rates its reasonable costs of providing service, including the cost of procuring electricity for its customers.[4] Unfortunately, the TURN accounting proposal adopted by the CPUC does not do that, but rather creates a situation in which SCE has no realistic way of recovering its costs.

This constitutes confiscation. Both federal courts and the California Supreme Court have made it clear that the regulated entity need not show that it will be driven into financial ruin in order to establish that a rate applicable to it is confiscatory, although in this case, that would hardly be difficult to do.[5] The California Supreme Court has made clear that the standards for a takings claim under the California Constitution are in accord with federal decisions and that a regulatory agency is required to take into account the utility's "interest in maintaining access to capital markets, the ability to pay dividends, and general financial integrity."[6]

Transferring purchased power costs to an account where recovery will likely be impossible violates this constitutional standard. Without federal court or legislative intervention, or a CPUC-designed means of recovering its purchased power costs, SCE will be forced to write off these costs permanently. If that were to happen, it would be a taking of SCE's property without just compensation.

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4 Indeed, under its agreement with Governor Davis, SCE has agreed to retain its remaining generation and sell the output to its customers at cost-based rates for 10 years.

5 See, e.g., Jersey Central Power & Light v. FERC, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (en banc). In that case, the District of Columbia Circuit found that the elements outlined in an earlier case – financial integrity, access to credit, ability to attract capital – were the "minimum requirements" to ensure against a constitutional taking. The court held that these constitutional requirements obligated FERC to consider evidence that the utility was unable to realize its operating and capital costs and that its ability to obtain credit was severely impaired. FERC could not ignore these facts in favor of a test that would require the utility to show that bankruptcy was imminent.

6 Calfarm Ins. Co. v. Deukmejian, 48 Cal. 3d 805, 818, n.9 (1989). See also 20th Century Ins. Co. v. Garamendi, 8 Cal. 4th 216, 296-97 (1994) (holding that a confiscatory rate is one that imposes the type of "deep financial hardship" described in Hope Natural Gas).

3) *How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?*

In order to understand the implications of the TURN Proposal, it is necessary to review briefly the AB 1890-era cost recovery system. At the heart of that system were the TCBA and TRA. The TCBA was designed to track transition costs (also known as "stranded costs") and the revenues used to offset those transition costs. It was necessary to create a separate account to track transition (as opposed to operating) costs because the rate freeze would end as soon as transition costs were fully recovered. Thus, only transition costs and the revenues which were allowed to offset them (including headroom, generation revenues, Rate Reduction Bond credits, and the above-book value of generation plants) were recorded in the TCBA. Operating costs, including power purchase costs, were separately recorded in the TRA. They were to be recovered as incurred.

In the past, TRA "headroom" was used as one means of offsetting transition costs. Headroom was calculated by taking the total revenues which SCE received in any given month (which were recorded in the TRA), and subtracting operating expenses (which were also recorded in the TRA.)[7] If headroom existed, that is to say, there was an excess of revenues over operating expenses, the headroom revenues were transferred from the TRA to the TCBA to offset transition costs. If headroom was a "negative,"[8] that is to say, operating expenses exceeded revenues, no transfer was made. Instead, the so-called "negative headroom" would remain in the TRA where it could be offset by revenues in following months.

The CPUC, in designing this process, rejected the concept of a transfer of "negative headroom," from the TRA to the TCBA. The CPUC noted that "none of the components in the TRA, including the CalPX payments, were prescribed as transition costs by law."[9] "Therefore, if negative balances from the TRA, whether generated by the entries related to the CalPX payment or any other components of the TRA, were to be allowed into the TCBA, effectively they would become transition costs eligible for cost recovery, which is inconsistent with the plain language of the statute."[10]

The TURN Proposal, recently adopted by the CPUC, represents a reversal of CPUC policy. Unfortunately, it has the effect that the CPUC warned against in Resolution E-3527 – it causes a pileup of additional costs in the TCBA that are not transition costs, but are treated as if they were transition costs. At this time, however, there is no means for SCE to offset those costs because most of the sources of cost recovery are gone.

Under AB 1890, the utilities were at risk for recovery of their "stranded costs" as defined by the statute. However, they were not at risk for recovery of their electricity procurement costs. This is the only interpretation of AB 1890 that is consistent with the long-standing federal filed rate doctrine. The U.S. Supreme Court has long held that federally tariffed rates must be passed through to customers. The basis for the Court's ruling is grounded in the supremacy clause of the constitution. The theory is that if the states were not required to pass through federally tariffed costs, they would be impermissibly interfering with the federal ratemaking scheme. AB 1890 established the CalPX as a FERC jurisdictional wholesale

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[7] This is a very general description of the headroom calculation.

[8] The "negative" is actually recorded in the TRA as a credit balance.

[9] Resolution E-3527, p. 5.

[10] Resolution E-3527, p. 5.

energy supplier. The CalPX's tariffs are on file with the FERC. Therefore, under well established federal law, the costs of energy purchased out of the CalPX must be passed through to customers. The CPUC's retroactive adoption of the TURN accounting proposal is nothing more than an attempt to dodge the application of the law to it by renaming the costs as "stranded costs" rather than what they really are: federally tariffed electricity procurement costs.

4) *With this new accounting procedure, will SCE be able to collect against its stranded costs as envisioned in AB 1890?*

AB 1890 provided four sources of "revenue" in which to recover the transition costs recorded in the TCBA: (1) "headroom," which was the excess of revenues over operating expenses; (2) revenues from SCE's retained generation plants; (3) Rate Reduction Bond imputed revenue; and (4) the above-book value of SCE's plants (sold or retained.)

The dysfunctional market, along with California ABX1-1 and ABX1-6, eliminate much of the utilities' means of recovering transition costs. ABX1-6 deprives SCE of an important source of revenue: it prohibits SCE from selling its generation plants and requires SCE to use the power from those plants "for the benefit of California ratepayers," thus depriving SCE of market-rate generation revenues or the gain on sale of plants.[11] Headroom did not exist for almost a year. Some headroom exists now only because CDWR is procuring SCE's net short position, but it may not be sufficient to make up for both the lost generation revenues and the past net undercollection.

What this means is that while the TURN Proposal adopted by the CPUC forces SCE to move purchased power costs into the TCBA, new California legislation took away almost all means of recovering costs in the TCBA.

The short answer to the question is that if the CPUC's adoption of the TURN accounting proposal stands, it is extremely unlikely SCE will be able to collect its stranded costs as envisioned in AB 1890.

FERC's Market Mitigation Plan

1) *Do you believe that FERC's market mitigation plan will help keep prices down this summer?*

The Federal Energy Regulatory Commission's (FERC) market mitigation plan is likely to be ineffective in reducing prices this summer. Since it only applies to Stage 1 or greater events, and it allows for marketers to sell to the CAISO with price limitations based only on their contract costs, the potential for evasion of any effective price mitigation is too great for the plan to be effective.

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[11] New P.U. Code § 377, enacted by Assembly BillX1-6. Even if ABX1-6 could be construed as permitting the sale of SCE's generation into the CalPX, it gives SCE little comfort, since the CalPX is no longer a functioning entity.

SCE believes the fundamental action to be taken by the FERC should be to deny market-based pricing authority unless/until it can be demonstrated that: 1. the wholesale electricity market is workably competitive; 2. electricity sellers cannot exercise market power; and 3. wholesale electricity prices resulting from the operation of the market are just and reasonable.

2) *Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?*

FERC's market mitigation plan has the potential to increase the number and magnitude of blackouts this summer. If California generators commit their output to marketers, they can evade the requirement to make power available in real time to the CAISO. If marketers can command a higher selling price to the CAISO by withholding some output, then there will be an incentive to do so. If the monitoring of such activity doesn't provide quick and effective penalties for such behavior, the potential for abuse could be great. California's recent experiences with all of these activities leads us to believe that blackouts are more likely under this plan than other recommended forms of market power mitigation, such as cost based bid limitations.

3) *Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?*

There do not appear to be any elements of the FERC plan that should discourage out-of-state generators from selling power to California.

4) *Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?*

Market power mitigation should be applied equally to all regions within a common market. Mitigation measures limited to a single state have the potential of encouraging exports from that state if the sellers can be successful at extracting greater market power rents from neighboring states, which are not subject to the same degree of price mitigation. FERC's market mitigation plan may not be an effective deterrent to the exercise of market power, thus its imposition, without improvement, to the entire WSCC may not produce the desired results.

5) *Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?*

To the extent that municipalities and power marketing administrations (PMAs) must abide by the CAISO tariffs in order to participate in the CAISO markets and make use of the CAISO operated grid, they should be required to abide by the market mitigation plan. The mitigation plan requires unscheduled power to be made available to the CAISO.

6) *Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?*

Brokers can effectively avoid the confines of FERC's market mitigation plan by reselling the power they purchase through bilateral transactions prior to sale to the CAISO. The limitations on the price of power ultimately sold to the CAISO in real time are thus virtually nonexistent. It is not an unusual practice for power to trade hands multiple times prior to delivery. That practice is now effectively rewarded with impunity from any price mitigation. This loophole is likely to completely eviscerate the mitigation plan.

7) *Will the plan protect consumers from megawatt laundering?*

Consumers will be entirely vulnerable to megawatt laundering. The practice of selling power out of the state to turn around and sell it back to the CAISO in real time when the CAISO is more desperate was a documented practice in the year 2000. With the potential to evade any and all price mitigation through this same practice in 2001, the incentive for its use is increased substantially. Consumers are entitled to protection from such schemes designed explicitly to manipulate prices. Thus far, no FERC action has provided consumers such protection, and the current FERC price mitigation plan provides a strong incentive to sellers to utilize such megawatt laundering schemes to gouge California's consumers.

SCE appreciates the Committee's earlier consideration in providing SCE with additional time in which to provide these answers.

Very truly yours,

Stephen E. Pickett

Stephen E. Pickett

cc: The Honorable Henry Waxman, Ranking Minority Member
House Committee on Government Reform

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May 22, 2001

Ms. Loretta Lynch
President
California Public Utilities Commission
505 Van Ness Avenue
San Francisco,California 94102

Dear President Lynch:

We are writing to follow up on the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs' April 10, 2001, hearing in Sacramento on the California electricity crisis. Thank you again for your testimony at that hearing. As discussed, we are submitting a series of written questions for your response. These questions, along with your written answers, will be included in the hearing record.

1. Bilateral Contracts:

During the Committee's April 10-12 field hearings, there was an extended debate on whether or not the California Public Utilities Commission (CPUC) constrained investor-owned utilities from entering into bilateral contracts in the summer of 2000. On April 10, you stated:

> *"Since I have been on the Public Utilities Commission, the utilities have asked ten times for authority for bilateral or forward contracts, or the authority to participate in hedging products. Every single time the Public Utilities Commission has allowed the utilities to do so."*

You further stated:

> *"August 3rd we said you buy your full net short, your choice, your business decision, and the utilities in fact did purchase bilateral contracts. We moved with lightning speed. They asked us on July 21st for authority, and we turned it around in two weeks and gave them full authority two weeks later. Then they started to buy, and they bought in August, in September, in October, in November. So I believe it is a canard to say that we stood in their way, because the facts show differently."*

Ms. Loretta Lynch
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However, your testimony stands in stark contrast to that of executives from Southern California Edison (SCE) and Pacific Gas and Electric (PG&E), who testified in San Jose on April 11. For instance, Stephen Pickett, Vice President and General Counsel of SCE stated:

> *"In July of 1999, they [CPUC] categorically rejected our request for authority to do bilateral contracts."*

With regard to the CPUC's August 3 order, Mr. Pickett stated:

> *"What was done then was only half the job. They gave us authority to enter into bilateral contracts; they gave us no assurance of recovery of the costs of those bilateral contracts. The two have to go together. If you do not have assurance of recovery you are not a creditworthy entity. You cannot get somebody to sign a contract with you."*

Mr. Pickett added:

> *"After we got the authority in August, the PUC set up a preapproval procedure. Ms. Lynch has often said well, the utilities had the authority in August, they could have gone and signed contracts on their own nickel. As I just explained, that is not a realistic expectation. They also set up this preapproval procedure you have just referred to. We filed our contracts under that preapproval procedure in September of 2000. By the end of October, even though there was a 30-day mandate in the PUC order, the PUC had not acted. We were ultimately able to sign those contracts only in November of 2000, well after we were beginning to run out of credit and people were beginning to refuse to deal with us."*

During two days of testimony, the Committee received starkly different versions of events. Please respond to the following questions:

a. Is it not correct that in July 1999, the Public Utilities Commission (PUC) rejected a proposal to allow investor-owned utilities to enter into bilateral contracts for electricity?

b. How do you respond to Mr. Pickett's contention that the Commission's August 3, 2000, order was meaningless without some assurance that the utilities would be allowed to recover their costs?

c. Is Mr. Pickett correct when he states that SCE sought preapproval of bilateral contracts in September 2000, but that preapproval was not granted until November 2000, at which point SCE was deep in debt and considered uncreditworthy?

d. If Mr. Pickett's contention is correct, how does that square with your April 10 statement that, "it is a canard to say that we stood in their way?"

The CPUC's June 8, 2000, Decision:

On June 8, 2000, you voted against allowing the utilities to enter into bilateral contracts outside the Power Exchange (PX). You were outvoted by other CPUC Commissioners 3-2.

Following the June 8, 2000, vote, the California State Legislature passed a bill that suspended this decision for one year.

With regard to PUC restrictions on bilateral or forward contracts in 2000, Commissioners Duque, Bilas and Neeper, all of whom voted to lift the restrictions, stated the following:

> *"[I]t is our belief that State restrictions on bilateral contracting and the purchasing of forward products led to an unstable situation where too much power passed through short term or spot markets, increased their volatility, minimized the power of buyers, and contributed to this summer's price spikes and high power costs.[1]"*

Please respond to the following questions:

a. Do you agree or disagree with the above-referenced statement of your fellow Commissioners?

b. Did you communicate your position on this issue to any members of the State Assembly or Senate? If so, to whom?

c. Did you actively lobby the Legislature to overturn the CPUC's June 8 decision?

d. Did you discuss this matter with Governor Davis?

3. CPUC Guidelines:

Along the same lines, there were sharp disagreements as to whether the CPUC issued useful guidelines for the utilities as to what constituted "reasonable rates." In your testimony, you stated:

> *"Our August 3rd standards are final. We could do additional refinements, which I proposed, which we have not finished. But we have guidance that we adopted on August 3rd. The utilities wanted additional guidance. We started designing additional guidance and then they dropped out of the market."*

[1] November 21, 2000 statement of Commissioners Bilas, Duque and Neeper.

Ms. Loretta Lynch
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The following exchange between Congressman Ose and Mr. Pickett of SCE on April 11 paints an entirely different picture:

Mr. Ose: *"Do you have anything from the PUC that in fact is final regarding what is reasonable relative to long-term forward contracts that you may wish to enter into?"*

Mr. Pickett: *"No, Sir."*

Mr. Ose: *"None?"*

Mr. Pickett: *"No, Sir ... the traditional standard for recovery of utility costs is that they be reasonable. The PUC has not issued, to my knowledge, guidelines that would say what is reasonable for utility procurement."*

Also testifying on April 11 was Dede Hapner, Vice President of Regulatory Relations of PG&E. She also weighed in on this issue:

"I believe that all three investor-owned utilities have submitted different criteria suggesting those be the basis for pre-approval standards, and to my knowledge none of those, nor any version of any of those has been approved."

Please respond to the following question:

a. How do you reconcile your testimony on April 10 with the testimony of Mr.Pickett and Ms. Hapner on April 11?

In your testimony, you state that every State requires utilities to abide by a reasonableness review standard when entering into long-term contracts. During the April 11 hearing, SCE and PG&E testified that the 5 percent standard utilized by the CPUC was a significant disincentive for them to enter into long-term contracts. In addition, CPUC Commissioners Bilas, Duque and Neeper stated in a November 21, 2000, filing with FERC that the CPUC had not provided the guidance that PG&E and SCE sought.

Please respond to the following questions:

a. What other States require their utilities to abide by a 5 percent standard, as the CPUC regulation has?

b. Does the CPUC believe it was encouraging or discouraging the utilities to enter into long-term contracts when the CPUC insisted on a 5 percent reasonableness standard?

c. Are there clear standards regarding the reasonableness review? If so, what is the specific section of the CPUC code that you are relying on in answering this question in the affirmative?

d. Does the CPUC have any plans to increase the reasonableness review standards in the future?

4. Stranded Costs:

The CPUC recently changed certain regulatory accounting principles for the investor-owned utilities that were agreed upon in 1998. This change has been referred to as the "TURN Proposal." Please respond to the following questions:

a. Why were the accounting principles changed?

b. Is the TURN Proposal more appropriate? Some have argued that the accounting change is a regulatory taking of assets.

c. What is the statutory legal authority for the CPUC to make this change?

d. How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?

e. With this new accounting procedure, will PG&E and SCE be able to collect against their stranded costs as envisioned in AB 1890?

f. Does the TURN Proposal establish a different standard for San Diego Gas and Electric than PG&E and SCE?

g. During our April 11 hearing, PG&E claimed that it had collected its stranded costs, thus ending the retail rate freeze. Has the CPUC reviewed this claim and either found in favor or against it?

5. Path 15:

There appears to be unanimous agreement that construction of Path 15 is needed to relieve transmission constraints in California. Testimony filed by the California Independent Service Operator (ISO) recommended that the Transmission Agency of Northern California and the Western Area Power Administration have the ability to complete Path 15 in the shortest time frame, and should be given the ability to do so. In recent orders, the CPUC preserved PG&E's right to build Path 15, thus preventing any other entities from contributing to the project. Since PG&E recently filed for Chapter 11 bankruptcy, we are concerned that the company lacks the ability to build this crucial connection to the California electricity grid.

Please respond to the following questions:

a. Why did the CPUC ignore the advice of the California ISO and prevent other interests from completing Path 15?

b. Have you discussed this matter with the Governor? What is his position?

c. Does the Governor have the ability to overrule the CPUC's decision?

6. Refinery Curtailments

The California Public Utilities Commission has not classified oil refineries as an "essential use" industry, and therefore they are subject to rolling blackouts this summer. The CPUC requested that the CEC report necessary changes to its April 3 decision. In response, the CEC recommended that the refineries be placed on "essential use" status. The committee is concerned that California might face an additional gasoline crisis if the refineries are forced to shut down for a prolonged period of time.

Please respond to the following questions:

a. Why has the CPUC not classified refineries under the "essential use" status?

b. How would the repeated interruption of electrical power to the refineries affect their operations and the California fuel markets?

c. What are the safety implications of shutting down a refinery at any time other than for scheduled maintenance, particularly given the lack of a proper advance notification system for a blackout?

d. Why has the CPUC ignored the CEC's recommendations to classify refineries under "essential use" status?

Ms. Loretta Lynch
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Thank you for your continued cooperation in this matter. In order to allow us to complete the hearing record in a timely fashion, please respond by Wednesday, May 30. If you have any questions please contact Committee Staff Director Kevin Binger at 202-225-5074.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

Cc: The Honorable Henry Waxman
Ranking Minority Member
Committee on Government Reform

The Honorable John Tierney
Ranking Minority Member
Subcommittee on Energy Policy,
Natural Resources and Regulatory Affairs

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May 11, 2001

Mr. Terry M. Winter
President and Chief Executive Officer
California Independent System Operator
151 Blue Ravine Drive
Fulsom, CA 95630

Dear Mr. Winter:

We are writing to follow up on the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs' April 10, 2001 hearing in Sacramento on the California electricity crisis. Thank you again for your testimony at that hearing. As discussed at the hearing, we are submitting a series of written questions for your response. These questions, along with your written answers, will be included in the hearing record.

The ISO Report on Electricity Overcharges

On March 21, 2000, the California Independent System Operator (ISO) issued a comprehensive report on the California electricity market. In the report, the ISO concluded that Californians were overcharged for power by $6.2 billion from May 2000 until February 2001. That estimate was later adjusted to include ancillary services, resulting in a re-estimate of $6.7 billion.

Please provide a breakdown of the $6.7 billion estimate by generator. Also, please indicate the amount that is under the jurisdiction of the Federal Energy Regulatory Commission (FERC) and the amount that comes after October 2, 2000, when FERC is legally able to consider refunds.

The FERC Market Mitigation Plan

In your testimony, you stated that, if FERC imposed a hard price cap, it would likely lead to more blackouts this summer. On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer.

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Will it lead to more or fewer blackouts this summer?

3. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities or Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration. The ISO will play a central role in administering the plan.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy marketers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Please provide the information requested in this letter to the majority staff in B-377 Rayburn House Office Building and the minority staff in B-350A Rayburn House Office Building not later than May 25, 2001. If you have any questions about this request, please call Committee Staff Director Kevin Binger at (202) 225-5074. Thank you for your attention to this request.

Sincerely,

Dan Burton
Chairman
Government Reform Committee

Doug Ose
Chairman
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs

cc: The Honorable Henry Waxman
The Honorable John Tierney

CALIFORNIA ISO

California Independent
System Operator

Terry M. Winter
President and Chief Executive Officer

June 6, 2001

The Honorable Dan Burton
Chairman, Government Reform Committee
2157 Rayburn House Office Building
Washington, DC 20515-6143

The Honorable Doug Ose
Chairman, Subcommittee on Energy Policy,
Natural Resources and Regulatory Affairs
B-377 Rayburn House Office Building
Washington, DC 20515

Dear Congressmen Burton and Ose,

On May 11, 2001, you wrote to me with a series of question following up on my testimony at the April 10 hearing of the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs in Sacramento, California. These questions are answered below in the order that you posed them.

I. ISO Report on Electricity Overcharges

1. **Provide a breakdown of the $6.7 billion by generator, FERC-jurisdictional status and date (before and after October 2, 2000):**

On March 30, 2001 the ISO received a Letter Order from the staff of the Federal Energy Regulatory Commission ("FERC" or the "Commission") addressing the analyses of California wholesale electric prices submitted to the Commission on March 22, 2001, and directing the ISO to "Separately identify the monthly amounts in the PX [California Power Exchange] and ISO markets, the monthly amounts attributable to each individual seller and the monthly amounts of jurisdictional and non-jurisdictional transactions in each of the markets." In the ISO's response to the Letter Order,[1] the ISO's Department of Market Analysis ("DMA") analyzed the hourly market activity of sellers into the ISO markets to estimate the degree to which estimated potential revenues for each transaction (and in the case of energy sold outside of the ISO markets, revenues estimates based on the volume of Final Hour Ahead energy schedules submitted to the ISO), exceeded the system-level competitive baseline price developed as part of previous analyses submitted to the Commission.[2]

The DMA analysis indicated that total potential revenues in excess of competitive levels in the

[1] *Response of California System Operator Corporation ("ISO") to Letter Order of March 30, 2001*, filed with the Commission on April 6, 2001, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/04/06/2001040616081028614.pdf; *Supplemental Response of California System Operator Corporation ("ISO") to Letter Order of March 30, 2001*, filed with the Commission on April 9, 2001, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/04/13/2001041316480226632.pdf

[2] *Impacts of Market Power in California's Wholesale Energy Market: More Detailed Analysis Based on Individual Seller Schedules and Transactions in the ISO and PX Markets*, available on the ISO website at: http://www2.caiso.com/docs/2001/04/13/2001041316491926706.pdf

wholesale market for ISO scheduled load exceeded $6.7 billion, including about $430 million in the Ancillary Services markets not accounted for in previous studies.[3] Approximately $4 billion of the $6.7 billion identified in this analysis can be tied directly to specific schedules and transactions in the PX and ISO markets, with the remaining $2.7 billion representing an estimate of potential bilateral market activity. Note that actual PX data (including block forward activity) were not available for use in the DMA analysis. Thus, PX market activity had to be estimated based on scheduling data submitted to the ISO (inter-SC trades between the PX and other market participants and imports scheduled with the ISO through the PX), and actual revenues may differ from estimated amounts. In addition, due to lack of information on bilateral forward contracts (which include, but are not limited to the PX block forward markets), one of the explicit assumptions of the analysis was that bilateral trades were valued based on prices in the Day Ahead PX market. The ISO is now aware of block forward trading data for some entities indicating that actual values differ - sometimes significantly - from this assumption. The following table is a compilation of data found in Impacts of Market Power in California's Wholesale Energy Market: More Detailed Analysis Based on Individual Seller Schedules and Transactions in the ISO and PX Markets, and distinguishes excess revenues of FERC jurisdictional sellers from excess revenues of non-jurisdictional sellers. It also breaks the estimated excess revenues into two periods: May through September, 2000 and October 2000 through February 2001.

Total Estimated Wholesale Revenues Above Competitive Market Baseline Non-Utility Distribution Company Market Participants (Million of Dollars)			
	FERC-jurisdictional Sellers	**Non-jurisdictional Sellers**	**Total Excess Revenues (1)**
Hour Ahead Energy Schedules (2)	$3,015	$1,321	**$4,338**
May-Sept	*$1,195*	*$585*	*$1,781*
Oct-Feb	*$1,820*	*$736*	*$2,557*
ISO Real Time Energy Purchases (3)	$1,286	$644	**$1,929**
May-Sept	*$554*	*$145*	*$698*
Oct-Feb	*$732*	*$499*	*$1,231*
ISO Ancillary Services Market (4)	$370	$70	**$439**
May-Sept	*$349*	*$68*	*$416*
Oct-Feb	*$21*	*$2*	*$23*
ISO System Totals	**$4,671**	**$2,035**	**$6,706**
May-Sept	*$2,098*	*$798*	*$2,895*
Oct-Feb	*$2,573*	*$1,237*	*$3,811*

(1) see *Impacts of Market Power*, footnote 3 above, Table 2.2
(2) see Table 2.5
(3) see Table 2.8
(4) see Table 2.9

[3] See report entitled *Further Analyses of the Exercise and Cost Impacts of Market Power in California's Wholesale Energy Market*, filed with the Commission on March 22, 2001, as an attachment to the ISO's *Comments of the California Independent System Operator Corporation on Staffs Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market*, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/03/22/2001032214580122891.pdf

Attachment A to this response provides a generator-specific breakdown of the total estimated wholesale revenues above the competitive market baseline. It separates totals for FERC-jurisdictional and non-jurisdictional entities, and for the periods May through September 2000 and October 2000 through February 2001. This data is a re-compilation of data provided under seal to the Commission in the ISO's April 9 filing, and is subject to the assumptions and limitations described above. We request that you treat this data as the confidential business information of the California ISO and refrain from any public release of Attachment A.

When interpreting Attachment A, it is important to remember that the purpose of the April 9 DMA analysis, and well as previous DMA studies, was to provide evidence of market power and the need to prevent such abuses in the future. These studies were intended to (1) quantify the potential overall impact of the exercise of market power on wholesale prices, and (2) provide evidence that overall market outcomes have resulted to some degree from the exercise of market power by individual entities, rather than solely from the effect of other market factors. However, they have been frequently mis-interpreted by the press and other entities as "alleged overcharges" by individual sellers that the ISO believes should be subject to refund. The ISO has repeatedly contended that further analyses may well be necessary or advisable before specific refunds by specific sellers should be ordered.[4] More importantly, perhaps, the Commission's November 1 and December 15 rulings indicate that sellers' actual costs – rather than an estimated competitive baseline price --- represent the appropriate benchmark for determining what refunds may be necessary to ensure "just and reasonable" outcomes for consumers. Thus, the ISO cautions against jumping to conclusions based on the generator-specific data in Attachment A.

2. Note on sales prior to October 2, 2000

While the question posed by the Committee could be read to suggest that the Commission's jurisdiction to consider refunds is limited to the period after October 2, 2000, and to sales by FERC-jurisdictional entities, these issues are far from being resolved. On April 9, 2001, the ISO filed an "Application for Rehearing" of the Commission's Order Directing Sellers To Provide Refunds of Excess Amounts Charged that, in part, addressed the issue of sales prior to October 2, 2000.[5] The ISO addressed this issue more recently in its May 25, 2001, "Emergency Motion for Immediate Suspension of Market-Based Rate Authority, for the Institution of Refund Proceedings, and Request for Shortening of Time" with respect to the authority of Williams Energy Marketing & Trading Company to sell energy and Ancillary Services from generating units in California at market-based rates.[6] As described in more detail on pages 26-30 of the May 25 Emergency Motion, relevant precedent provides both the authority and the obligation for the Commission to examine whether rates were just and reasonable during the entire period since at least May, 2000, and not merely the period beginning October 2, 2000.

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[4] For example, while the ISO believes conservative assumptions of sellers' costs were used in the analyses underlying the reports (i.e., that the assumptions almost surely *overstated* sellers' actual costs), the assumptions were not based on the actual costs experienced by any specific seller as that data was unavailable to the ISO (and unfortunately remains unavailable, despite the ISO's requests). Analysis of specific sellers' actual costs, as well as other factors deemed relevant to a determination of justness and reasonableness of prices (such as actual terms of forward market contracts), may well need to be undertaken before a determination of refund responsibility could be made.

[5] *Application for Rehearing of the California System Operator Corporation*, filed with the Commission April 9, 2001, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/04/13/2001041311553388246.pdf

[6] *Emergency Motion of the California ISO for Immediate Suspension of Market-Based Rate Authority, for the Institution of Refund Proceedings, and Request for Shortening of Time to Answer*, filed with the Commission May 25, 2001. Docket No. ER99-1722, available at the ISO website at: http://www2.caiso.com/docs/2001/05/25/2001052515535622635.pdf

While the Commission's authority to order refunds under the Federal Power Act is limited by the "filed rate doctrine," the Commission has recognized that this limitation does not apply to "formula rates" that permit the rate to fluctuate without prior review. Formula rates are an exception to the general requirement under the Federal Power Act that utilities must seek Commission approval for every change in the rates charged for wholesale electricity. Federal courts have held that a utility authorized to charge formula rates can change the rates they charge for electricity without filing or public notice, "provided those changes are consistent with the formula." The Commission has already found that certain aspects of the ISO tariff constitute a formula rate, but many other aspects of the ISO tariff involve charges and payments that pass through the ISO according to formulas, and should be similarly exempt from the filed rate doctrine. As a result, the ISO believes that these charges and payments incurred prior to October 2, 2000 continue to be subject to Commission review to ensure just and reasonable rates.

The wholesale sales of suppliers through the ISO's markets for all practical purposes are indistinguishable from sales pursuant to formula rates. Charges under market-based rates are, like charges under formula rates, affected by factors and circumstances that are not included in the rate itself. Since utilities collecting market based rates for wholesale sales of electricity in the California markets do not file rate schedules at the Commission showing the specific rates they will charge, the normal prohibition on retroactive adjustments of amount collected under "filed rates" accordingly should not apply. It is the ISO's view that there is no legal basis for the Commission to limit the period during which, or the extent to which, it will scrutinize wholesale sales of electricity under its market based rate authority. Therefore, while the ISO has to the extent possible, distinguished between pre- and post-October sales in its response to the Committee's question, the ISO believes that the pre-October sales are not shielded from potential refund orders.

3. Note on sales by non-jurisdictional entities

While the Committee appears to be focusing on sales by FERC-jurisdictional entities, you should be aware that some parties have argued that <u>all</u> sales of power through the ISO-controlled grid are subject to FERC rate jurisdiction, regardless of the jurisdictional status of the generator. For example, San Diego Gas and Electric Company has argued that under the Commission's *City of Vernon* decision,[7] once a non-public utility chooses to participate in the ISO's market-based mechanisms, it must accept and submit to the Commission's authority to ensure that the resulting rates are just an reasonable.[8]

Southern California Edison ("Edison") and Pacific Gas and Electric Company ("PG&E") have argued that the unjust and unreasonable rates at issue are the rates charged to the utilities by the ISO and PX, which are clearly subject to FERC rate jurisdiction. Edison and PG&E point out that non-jurisdictional entities that sell into the ISO markets are "Market Participants" under the ISO Tariff, and under section 14.3 of the Tariff, all Market Participants contractually agree to indemnify the ISO against all claims and liabilities arising from their actions. Edison and PG&E argue that relevant precedent provides the Commission with the authority and obligation to evaluate non-jurisdictional activities to the extent they affect the Commission's jurisdictional responsibilities. In this view, the Commission should identify any non-jurisdictional sellers whose actions gave rise to refund liability and delay payment by the ISO or PX on indemnification by the seller.[9] Accordingly, potential refunds may not limited to sales by FERC-jurisdictional sellers.

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[7] *California Independent System Operator Corporation and City of Vernon, California, Order Denying Rehearing,* Docket Nos. ER00-2019-003 and EL00-105-002 (February 21, 2001) available on the ISO website at: <u>http://www2.caiso.com/docs/2001/05/23/2001052318582416228.pdf</u>

[8] *Request for Rehearing of San Diego Gas and Electric Company*, Docket No. EL00-95 (April 9, 2001), at p. 17.

[9] *Request for Rehearing of Southern California Edison Company and Pacific Gas and Electric Company,* Docket No. EL00-95, (April 9, 2001) at pages 32-37.

II. FERC Market Mitigation Plan

The Committee's letter references my statement at the April 10, 2001 hearing in Sacramento regarding my belief that price caps would be a deterrent to attracting new generation in California. My statement has been cited widely to imply the California ISO's support for market-based rates and our opposition to market mitigation measures that would help control prices in California and the West.

I understand the term "price cap" to mean a prohibition imposed solely in select ISO markets that would preclude the ISO from accepting bids in these markets above a fixed dollar amount. It could also mean a prohibition on the ISO making any out-of-market purchases at prices above that dollar amount. As the ISO has stated on numerous occasions, any market mitigation proposal that is limited to the ISO markets and dispatch authority alone is likely to be ineffective. This is so because, under such a proposal, market participants would remain free to circumvent the mitigation measures by focusing their activities in other markets (for example, out of state) that are not mitigated. In addition, such a limited mitigation proposal would place the ISO and the State of California at a competitive disadvantage in securing scarce energy resources and would thus make the ISO's job more difficult. Limited price caps could very well impede the ISO's ability to purchase electricity necessary to meet demand this summer.

This does not mean that I am opposed to all forms of market mitigation measures. To the contrary, where market power is being exercised, FERC has a duty to impose mitigation measures sufficient to return markets to just and reasonable levels, and we have offered a plan to accomplish that.

The ISO's analyses show that wholesale electricity markets in California are not currently competitive and, indeed, have not been competitive for at least the past year. Our analyses also show that prices since May, 2000, have greatly exceeded any signal necessary to encourage additional supply. FERC itself has found, in its December 15, 2000 Market Order Proposing Remedies for California Wholesale Electric Structure, that market structures and rules for competitive wholesale sales of energy in California are seriously flawed and that conditions ensuring just and reasonable rates do not exist in the State.

FERC's actions to date have addressed the situation incompletely, permitting wholesale suppliers to continue to exercise market power unless an electricity emergency exists and to continue to extract unprecedented prices for electricity in the California wholesale market. FERC's continued authorization of market-based rates within an uncompetitive market fundamentally exploits consumers and threatens the economic stability of the entire state and region. This situation is unconscionable, and we have asked FERC to act expeditiously to remedy it. We believe that, in accordance with its statutory mandate, FERC must either limit wholesale suppliers to cost-based rates or, failing that, condition the continued use of market-based rates on effective mitigation measures that do not involve price caps as described above.

1. Will FERC's April 26th market mitigation plan help keep prices down this summer?

At this point, we do not know the answer to this question. However, given the numerous loopholes and limitations in the April 26 Order, the extent of any mitigation is likely to be small. In the Order, "the Commission adopts a market monitoring and mitigation plan for the California market to replace the \$150/MWh breakpoint plan adopted in its December 15, 2000 Order."[10]

[10] *Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets,*

The Commission's plan provides for: (1) increased authority for the ISO to coordinate and control Outages of certain Generating Units; (2) a requirement that sellers with Participating Generator Agreements as well as non-public utility sellers within California that utilize the ISO-controlled grid offer all their available power in real time; (3) the establishment by public utility load serving entities of response mechanisms in which they would identify a price at which load should be curtailed during all hours; (4) the use of a single market clearing price auction for the ISO Imbalance Energy Market; and (5) mitigation of ISO Imbalance Energy Market prices during periods in which the ISO is experience a reserve deficiency. The April 26 Order also imposes general conditions on public utility sellers' market based rate authority by prohibiting certain anomalous bidding strategies and reporting requirements.

Despite the further deterioration of the California wholesale electricity market, the April 26 Order offers in effect even less mitigation than the plan it would replace. The Order improperly limits price mitigation to a narrow set of system conditions. In the December 15 Order, the Commission applied the $150 breakpoint methodology - and recognized the importance of extending price mitigation - to all hours. As evidenced by the ISO's recent filing against the Williams Company, the experience of the last few months has clearly demonstrated that the mitigation procedures adopted in the December 15 Order have been wholly inadequate to curtail market power abuses.[11] In contrast to the December 15 Order, the April 26 Order unduly restricts price mitigation to System Emergency conditions. Such an approach is contrary to the established record that shows market power abuse is widespread whether or not System Emergency conditions exist.[12]

The ISO believes that the factors used in the April 26 Order to determine the Proxy Price for price mitigation are unfounded and will unreasonably inflate the market clearing price. This will also result in overstating the rates necessary to serve as an incentive to attract new Generation. Under the April 26 Order, the ISO is to estimate the marginal cost for each Generator by using the resource-specific heat rate, a proxy for the gas costs and emissions costs of the Generator, and a $2.00 adder for operation and maintenance expenses. First, most units do not have to pay for NOx emissions, and for those who do, the Commission's methodology inflates the true cost of emission credits. Second, the Commission's methodology for estimating gas costs (based solely on spot market prices) fails to replicate how generators purchase gas, and will likely overestimate Generators' fuel costs. Combined, these factors inflate the Proxy Price well above Generators' true marginal costs.

It initially appeared that the real-time mitigation scheme proposed in the April 26 Order, in its replacement of the $150/MW "soft cap" put in place by the December 15 Order, would leave

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Docket No. EL00-95-0012 (April 26, 2001), slip opinion at 1 (the "April 26 Order"), available on the ISO website at: http://www2.caiso.com/docs/2001/04/27/2001042712385625076.pdf

[11] See the ISO's filing seeking immediate suspension of the market-based rate authority of the Williams Energy Marketing & Trading Company, *Emergency Motion of the California Independent System Operator Corporation for Immediate Suspension of the Market-based Rate Authority and for the Institution of Refund Proceedings*, Docket No. ER99-1722-0004, May 25, 2001, available on the ISO website at: http://www2.caiso.com/docs/2001/05/25/2001052515535622635.pdf

[12] See, *Comments of the California Independent System Operator Corporation on Staff's Recommendation of Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Markets*, filed with the Commission on March 22, 2001, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/03/22/2001032214541122276.pdf

See also, *Empirical Evidence of Strategic Bidding in the California ISO Real Time Market*, filed with the Commission on March 22, 2001, Docket No. EL00-95, available on the ISO website at: http://www2.caiso.com/docs/2001/03/22/2001032214585222924.pdf

Ancillary Services capacity bids entirely unmitigated.[13] On May 25, 2001, the Commission issued an "Order Providing Clarification and Preliminary Guidance on Implementation of Mitigation and Monitoring Plan for the California Wholesale Markets."[14] In the May 25 Order, the Commission clarified that the ISO should use the "relevant average hourly mitigated Imbalance Energy price" to establish the market clearing price in the Ancillary Services market. Under the April 26 Order, price mitigation in the ISO's real-time Imbalance Energy only applies during System Emergency conditions. Because Ancillary Services are procured in advance of the real-time market, it appears that prices in the Ancillary Service Market will only be mitigated on a retroactive basis, after the ISO determines if price mitigation will apply in real-time. The ISO is still assessing the impact of the May 25 Order with respect to Ancillary Service price mitigation, but is concerned that this order would leave Ancillary Service prices without any prospective price mitigation and will only provide retroactive price mitigation during a limited number of hours. This is not a trivial matter. Ancillary Services costs are significant in California, and are a causative factor of higher costs in the ISO's real-time Imbalance Energy market.[15]

Despite championing the attributes and benefits of regional coordination and markets, the Commission has left wide open California's regional "back door" and totally failed to address the megawatt laundering issue – a problem that can only be effectively addressed through regionally-applicable price mitigation measures. The Commission's sole action in this regard was to initiate a WSCC-wide section 206 investigation into spot market transactions in the West that cannot hope to bring any measure of relief in the foreseeable future.

In sum, the April 26 order establishes improper price signals, fails to impose price mitigation during periods and in markets were market power continues to be exercised and fails to address megawatt laundering.

2. Will it lead to more or fewer blackouts this summer?

The ISO recognizes the importance of new Generation to California. In the long-run, the addition of such Generation will alleviate the risk of blackouts in California. The state is making significant strides in expediting the approvals for new facilities. Nevertheless, the need for new supply does not justify excessive prices well beyond those necessary to fulfill this objective. As Commissioner Massey has recognized,

> Soaring prices will not get even one more megawatt of generation built by this summer. Not one. The price signal has been sent. For this summer, high prices are all pain, no gain. I fear that high prices are already damaging the western economy.[16]

The California Energy Commission ("CEC"), in its March 30, 2001 Comments in Docket No. EL01-47-000, stated that the state is negotiating long-term contracts to encourage continued power plant construction and that "[c]ontinued or increasing high prices beyond any reasonable level, instead of causing more power plant applications this year, will simply aggravate a burden-of-payment and credit crisis that increasingly clouds the financial outlook for both existing and new projects."[17] The CEC's comments are in agreement with the testimony of Ms. Marilyn Showalter, the Chairwoman of the Washington Utilities and Transportation Commission:

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[13] In the ISO's compliance filing with the April 26 Order, submitted in this proceeding on May 11, 2001, the ISO eliminated Tariff provisions related to the $150/MW soft cap on Ancillary Services capacity, but requested that the Commission immediately address the issue of Ancillary Service price mitigation.

[14] *Order Providing Clarification and Preliminary Guidance on Implementation of Mitigation and Monitoring Plan for the California Wholesale Markets*, Docket No. EL00-95-012 (May 25, 2001).

[15] See *Impact of Market Power*, note 2 above.

[16] Transcript of the April 10, 2001 conference in Boise, Idaho at 19.

[17] CEC March 30, 2001 Comments at 4.

In other words, the very prices that you hope are sending signals to develop new supply or to bring on existing supply are, in fact, producing such instability and such uncertainty on the west coast, that they are accomplishing the opposite effect. ...[A]n unfettered price signal to resource developers is useless for bringing [on] new capacity, if at the same time[, i]t produces instability and uncertainty such that the financial markets are not willing to commit capital. And this is the story that I hear.[18]

3. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

To be effective, any market mitigation plan should not be limited to California. Given the degree of integration of electricity markets throughout the western region and California's position as a net importer during significant period of the year, California-only price mitigation creates incentives for suppliers to withhold supply from California. Moreover, the tight supply conditions that have plagued California are a problem throughout the western region and therefore, spot market sales in non-California markets in the west may not be just and reasonable under certain conditions and should thus be mitigated.

Finally, limiting the mitigation plan to California creates the opportunity for "megawatt laundering" as described in more detail below.

III. Application to entities outside FERC jurisdiction

1. Will municipalities and PMAs have to abide by FERC's market mitigation plan?

In the April 26 Order, the Commission established a requirement that all non-hydroelectric Generators in the State of California "offer the ISO all of their capacity in real time if it is available and not already scheduled to run through bilateral agreements." This "Must-Offer" requirement applies not only to Participating Generators under FERC jurisdiction, but to all "non-public utility sellers that own or control generators in California" as a condition to their participation in the ISO's markets or use of the ISO Controlled Grid.[19] Both Participating Generators and non-public utility-gas fired generators are subject to real-time price mitigation based on the Proxy Price approach described above.

On May 11, 2001 the ISO proposed revisions to its Tariff to implement the April 26 Order. To the extent that a municipality or power marketing administration meets the criteria established by the Order (referred to in the tariff as "Must-Offer Generators"), all of its generating facilities located in California will be subject to the Must-Offer requirement of the market mitigation plan. Any Must-Offer Generator (including municipalities and PMAs) that submits a bid above its Proxy Price will be required to provide cost justification data to the ISO and the Commission.

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[18] Transcript of the April 10, 2001 conference in Boise, Idaho at 31. *See also* the testimony of Mr. Roy Hemmingway energy advisor to Governor Kitzhaber of Oregon, posing the question, "will unregulated prices bring additional generation into the marketplace in time to meet the immediate problem of lack of generation in the western marketplace? And I think the answer to that clearly is no," and the testimony of Ms. Connie White of the Utah Public Service Commission quoting Alfred Kahn for the proposition that "[p]rices can skyrocket to unproductively high levels where the pain inflected outweighs the relatively small benefit. The amount of additional conservation and additional imp[etus] to build more capacity you'll get is not worth it," and suggesting that "[w]e may have reached this point in the west." *Id.* at 79 and 36. With regard to the "question of whether the inherently volatile market prices for energy can send appropriate price signals to the changing s[uppliers] of new generation," Ms. White expressed her "agreement with what Chairwoman Showalter was saying." *Id.* at 37.

[19] April 26 Order, slip op. at 10.

Finally, I would note that the California Municipal Utilities Association has committed to Congress and the Commission that its members will adhere to cost based price caps once implemented by FERC.[20]

2. Will energy marketers be able to avoid the confines of the plan

Yes. The ISO has requested changes in its Tariff to require energy marketers to submit cost justification data as required by the April 26 Order. The new Tariff language will require that, "The cost justification for bids submitted on behalf of non-Scheduling Coordinator Market Participants [such as out-of-state marketers] shall include a detailed breakdown of the prices paid by that non-Scheduling Coordinator Market Participants for the Energy bid."[21] However, the ISO recognizes that this requirement will not prevent energy marketers from engaging in a series of transactions (a "daisy chain") that will effectively prevent the ISO from identifying which generating unit produced the power in question. Without this data, the ISO will not be able to assess whether the marketer's price exceeds the Proxy Price for the generating unit (regardless of whether that generating unit is in California or elsewhere).

Even if the ISO was provided with all the data necessary to identify every energy marketers in the daisy chain between the generator and the final purchaser of the electricity, FERC's plan would not prevent exorbitant prices. Each marketer in the chain could justify its bid price by pointing to its purchase cost plus an increase to cover its profit margin. Such daisy chain transactions, with each marketer adding its own percentage for profit, could result in a final bid price that vastly exceeds the marginal cost of producing the power, but is "justified" under FERC's plan.

3. Will the plan protect consumers from megawatt laundering?

No. "Megawatt laundering" is the ability of generators within California to schedule power – that would be subject to price mitigation if sold in the state – for export in the forward markets, permitting power marketers to sell this power back to the ISO at unmitigated prices in the real-time market. The cost justification requirements of the April 26 Order will not prevent megawatt laundering as the ISO will only be able to see the price paid by the final marketer in the daisy chain of transactions. And even if the ISO had all the data, justification by reference to the purchase price does not protect the consumer. Only by applying an adequate mitigation plan region wide can megawatt laundering be addressed.

If you have any further questions, please contact me at (916) 351-2366.

Sincerely,

Terry M. Winter
President & Chief Executive Officer

Attachment

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[20] See, letter to Commissioner Breathitt, April 27^{th}, 2001 in Docket No. PL01-3-00, and testimony of David Freemen and Jim Pope before the House Energy and Commerce Committee, Energy and Air Quality Subcommittee, March 22, 2001.

[21] ISO Tariff at section 2.5.23.3.5.

California ISO - Confidential **Attachment A**

FERC-Jurisdictional Generators
Estimated Wholesale Revenues Above Competitive Market Baseline
(Pre and Post October, 2000)

NAME		MAY - SEPT.		OCT. - FEB.		TOTAL
American Electric Power Service Corp	$	12,803,084	$	10,102,496	$	22,905,579
Arizona Public Service Company	$	(15,778,131)	$	(8,896,316)	$	(24,674,447)
Automated Power Exchange, Inc	$	13,904,968	$	2,960,631	$	16,865,599
Aquila Power Corporation	$	19,684,436	$	8,473,663	$	28,158,099
Avista Energy Inc	$	30,126,654	$	18,742,450	$	48,869,104
British Columbia Power Exchange Corporation	$	308,588,128	$	131,335,896	$	439,924,023
Calpine	$	61,361,554	$	174,692,149	$	236,053,703
California Polar Power Brokers, LLC	$	-	$	-	$	-
CONSTELLATION POWER SOURCE, INC.	$	4,392,721	$	3,486,908	$	7,879,629
Cargill-alliant, LLC	$	(1,262,933)	$	(177,992)	$	(1,440,925)
Coral Power, LLC	$	1,362,858	$	25,770,030	$	27,132,888
Citizens Power Sales	$	557,767			$	557,767
Duke Energy Trading and Marketing, L.L.C.	$	350,315,012	$	454,359,173	$	804,674,185
Electric Clearinghouse, Inc	$	280,434,453	$	249,919,543	$	530,353,996
Enron Energy Services, Inc.	$	27,319,152	$	12,593,387	$	39,912,539
El Paso Electric Company	$	24,475			$	24,475
El Paso Power Services Company	$	2,898,465	$	27,063,567	$	29,962,032
Hafslund Energy Trading, LLC	$	(712,528)			$	(712,528)
Illinova Energy Partners, Inc	$	-	$	-	$	-
Idaho Power Company	$	(2,467,490)	$	30,628,123	$	28,160,633
Koch Energy Trading, Inc.	$	2,433,157	$	115,779	$	2,548,935
Louisville Gas and Electric Company	$	-	$	-	$	-
MDSC	$	6,061,286	$	18,112,214	$	24,173,499
Mieco, Inc.	$	1,352,107	$	316,754	$	1,668,861
Morgan Stanley Capital Group	$	-	$	124,644	$	124,644
NewEnergy Inc.	$	(1,722,951)	$	163,519	$	(1,559,432)
Nevada Power Company	$	5,969,148	$	3,131,661	$	9,100,809
PacificCorp	$	(51,190,445)	$	(13,975,729)	$	(65,166,174)
PECO Energy Company	$	1,979,160	$	2,283,856	$	4,263,016
Portland General Electric	$	16,091,262	$	28,292,107	$	44,383,369
PPL Montana	$	-	$	-	$	-
Public Service Company of Colorado	$	13,583,314	$	533,341	$	14,116,655
Puget Sound Energy	$	498,926	$	23,983,055	$	24,481,981
Public Service Company of New Mexico	$	18,435,318	$	(2,853,913)	$	15,581,405
Reliant Energy Services, Inc.	$	372,200,711	$	378,006,392	$	750,207,102
Southern Company Energy Marketing, L.P.	$	268,990,341	$	484,958,194	$	753,948,534
Sempra Energy Trading Corporation / San Diego Gas and Electric*	$	49,785,627	$	32,517,392	$	82,303,020
Sierra Pacific Power Company	$	(26,930,457)	$	3,440,151	$	(23,490,306)
TEK	$	9,534,123	$	2,144,999	$	11,679,122
Tuscon Electric Power	$	1,156,535	$	6,125	$	1,162,660
UPA	$	131,715			$	131,715
Winston and Strawn			$	11,917	$	11,917
Williams Energy Services Corporation	$	355,464,293	$	505,458,963	$	860,923,257
Total FERC-jurisdictional Generators	**$**	**2,137,375,812**	**$**	**2,607,825,130**	**$**	**4,745,200,942**
*Total without SETC/SDG&E					**$**	**4,662,897,922**
GRAND TOTAL - FERC AND NON-FERC GENERATORS	**$**	**2,935,076,813**	**$**	**3,844,189,778**	**$**	**6,779,266,591**
*GRAND TOTAL MINUS SETC/SDG&E:					**$**	**6,696,963,572**

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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WASHINGTON, DC 20515–6143

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May 16, 2001

Ms. Dede Hapner
Vice President of Regulatory Relations
Pacific Gas and Electric Company
700 11th Street, NW, Suite 250
Washington, D.C. 20001

Dear Ms. Hapner:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 11 in San Jose. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Transfers to Parent Corporations:

At the April 11 hearing, several Members requested that Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) provide information on profits generated and funds transferred to parent companies. For instance, Congresswoman Lofgren asked:

> *"I am wondering if I could ask you, Ms. Hapner, -- and my constituents talk to me about this all the time – how much was transferred from PG&E to its parent corporation, what is the dollar figure?"*

You responded by stating:

> *"I do not have the exact amount, I would just reiterate that all actions that we took were in compliance with the Commission rules. I will get you that exact amount."*

In his testimony, Steven Pickett of SCE testified that there are three categories of allowable transfers from regulated utilities to their parent companies: 1.) dividends of earnings 2.) payments of taxes and 3.) special dividends.

Ms. Dede Hapner
Page 2

Please respond to the following questions:

1. What was PG&E's net income and return on assets in 1999 and 2000?

2. What was PG&E's net income and return on assets for the first three months of 2001?

3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

4. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 1999 and 2000.

5. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 2001 prior to declaring bankruptcy.

Long-Term Contracts:

There have been numerous press reports that the investor-owned utilities in California received offers of long-term contracts at five cents per kilowatt hour in the summer of 2000. On April 11, you were asked if PG&E had received such offers during that time period. You responded:

> *"When we investigated those offers, they were not what they appeared to be and what were covered in the media. ... They were considerably higher than five cents, particularly for peak periods."*

Please respond to the following question:

1. Please describe in detail the terms and conditions of the long-term contract proposals received by PG&E in the summer of 2000.

Bilateral Contracts

At both the April 10 and April 11 hearings, there was a great deal of discussion about the California Public Utilities Commission's August 3, 2000, order allowing regulated utilities to enter into bilateral contracts. The discussion centered around whether that order granted the utilities sufficient authority to lock in relatively low long-term rates before the market exploded.

Ms. Dede Hapner
Page 3

On April 10, CPUC President Loretta Lynch testified that:

"On a unanimous vote two weeks after the utilities asked for the authority to enter into bilateral contracts, the PUC did give the utilities the authority to enter into bilateral contracts, and then they entered into bilateral contracts. I am prevented, for confidentiality reasons, from telling the public exactly what they entered into, but I can tell you they entered into significant bilateral contracts."

On April 11, you stated that PG&E did in fact sign some bilateral contracts following the CPUC's August 3 order:

"We finally went out at our own risk, and we still do not have reasonableness protection, but we actually went out at our own risk and signed a series of contracts, several of them at about 5.5 cents."

While you did not at the time have the details of those contracts, you offered to provide them to the Committee. Please respond to the following questions and requests for information:

1. Please describe in detail the terms and conditions of the bilateral contracts into which PG&E entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.

2. Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that PG&E did in fact enter into some contracts following the August 3 order?

3. What is your interpretation of the CPUC's "reasonableness" standards?

4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

Stranded Costs

The CPUC recently changed certain regulatory accounting principles for the investor-owned utilities that were agreed upon in 1998. This change has been referred to as the "TURN Proposal." Please respond to the following questions:

1. Does PG&E consider the TURN Proposal a more appropriate standard?

2. Some have argued that the accounting change is a regulatory taking of assets. What are the views of PG&E on this subject?

3. How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?

4. With this new accounting procedure, will PG&E be able to collect against its stranded costs as envisioned in AB 1890?

FERC's Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Ms. Dede Hapner
Page 5

Thank you for your continued cooperation in this matter. In order to allow us to complete the hearing record in a timely fashion, please respond by Friday, May 25. If you have any questions please contact Full Committee Staff Director Kevin Binger at 202-225-5074.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

Cc: The Honorable Henry Waxman
Ranking Minority Member

Pacific Gas and Electric Company

Dede Hapner
Vice President
Regulatory Relations

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June 4, 2001

The Honorable Dan Burton
Chairman, Committee on Government Reform
United States House of Representatives
Washington, DC 20515

RECEIVED
JUN 1 1 2001
Doug Ose, M.C.
Washington, DC

The Honorable Doug Ose
Chairman, Subcommittee on Energy Policy,
Natural Resources, and Regulatory Affairs
United States House of Representatives
Washington, DC 20515

Dear Chairmen Burton and Ose:

In response to your letter of May 16, 2001, Pacific Gas and Electric Company is pleased to provide responses to your questions in follow-up to the Government Reform Committee's field hearings in San Jose, California of April 11, 2001.

Thank you for the opportunity to testify. We appreciate your personal efforts and that of the Committee to investigate and help arrive at solutions to the energy crisis now encompassing the state of California and the west. We are committed to continue working with you in any way possible to find such solutions.

Again, thank you for the opportunity to testify. Please let us know if we can provide any additional information.

Sincerely,

Dede Hapner

cc: Members, House Committee on Government Reform
The Honorable Mary Bono
The Honorable Lois Capps
The Honorable Christopher Cox
The Honorable Anna Eshoo
The Honorable Jane Harman
The Honorable Mike Honda
The Honorable Barbara Lee
The Honorable Zoe Lofgren
The Honorable George Radanovich

Transfers to Parent Corporation

Q1. What was PG&E's net income and return on assets in 1999 and 2000?

Pacific Gas and Electric Company

Year	Net Income (Loss)	Return on Assets
	$ millions	
1999	$ 788	6.22%
2000	($ 3,483)	(13.18%)

Q2. What was PG&E's net income and return on assets for the first three months of 2001?

Pacific Gas and Electric Company

Year	Net Income (Loss)	Return on Assets
	$ millions	
2001, 1st Quarter	($ 944)	(3.6%)

If first quarter returns are annualized, the return on assets would be a loss of approximately 14.3%.

Q3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

The following table provides ten years of the requested data:

Pacific Gas and Electric Company

Year	Net Income (Loss)	Return on Assets
	$ millions	
1991	$ 1,026	8.06%
1992	$ 1,170	8.31%
1993	$ 1,065	7.15%
1994	$ 1,007	6.32%
1995	$ 1,338	7.43%
1996	$ 755	5.26%
1997	$ 768	5.22%
1998	$ 729	5.61%
1999	$ 788	6.22%
2000	($ 3,483)	(13.18%)

Q4. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 1999 and 2000.

The requested information is provided in the following table. Although there were no special dividends paid during this period, the table provides data for stock repurchases, which are included in this response for completeness.

Pacific Gas and Electric Company
Transfers to PG&E Corporation
($ millions)

Year	Dividends	Stock Repurchases	Income Taxes
1999	$ 415	$ 275	$ 1,000
2000	$ 475	$ 275	$ 0

In 1997, PG&E Corporation, a holding company for the regulated utility and unregulated subsidiary businesses, was formed. Prior to this time, Pacific Gas and Electric Company would pay dividends and income taxes directly to the shareholders or governmental entities. Since the formation of the holding company, the utility (as well as the subsidiary companies) calculates dividends and income taxes as if it were an independent company, but transfers these obligations to the holding company, which in turn pays dividends to shareholders or files consolidated income tax returns. Also, due to capital recovered from the sale of the utility's generation assets and in order to maintain a balanced capital structure and comply with California Public Utility Commission (CPUC) policy, PG&E Corporation repurchased some of its stock. In addition to the numbers above, there were also smaller transfers of funds between the utility and corporate parent that were reimbursements for administrative services provided by the corporation on behalf of the utility.

All interactions between the utility and the holding company are governed by regulations issued by the CPUC. Moreover, since the formation of PG&E Corporation, CPUC-ordered audits have found Pacific Gas and Electric Company to be in compliance and have issued no penalties. Finally, the CPUC and consumer advocates have reviewed Pacific Gas and Electric's financial policies and transactions annually in rate of return proceedings and have not disputed their propriety.

Q5. For each of the three categories of allowable transfers listed above, please specify how much money PG&E transferred to its parent company in 2001 prior to declaring bankruptcy.

There were no dividends, stock repurchases, special dividends, or income taxes paid from Pacific Gas and Electric Company to PG&E Corporation in the first quarter of 2001.

Additional Response to Hearing Question:

At the San Jose hearing on April 11, 2001, Congresswoman Barbara Lee asked some questions about the impact of the Chapter 11 bankruptcy filing on Pacific Gas and Electric's employees and retirees. To provide further information on those questions, included as "Attachment A," is a copy of an e-mail from the utility's vice president-human resources that was sent to all company officers, directors and department heads to be shared with their respective employees. The message provides information on employee compensation, benefits, retirement plan and other employee-related issues. PG&E's bankruptcy has no impact on our retirees' rights to receive benefits from our qualified pension plan.

Long-term contracts

Q1. Please describe in detail the terms and conditions of long-term contract proposals received by PG&E in the summer 2000.

Following the CPUC's August 3, 2000, decision allowing the utilities to enter into bilateral contracts, Pacific Gas and Electric Company issued a request for offers (RFO) in September, with bids to be accepted on October 11, 2000. PG&E requested bidders to provide energy offers for up to five years. Table 1 provides information in tabular format regarding all bids submitted by producers in October 2000. PG&E accepted final bids on October 11, 2000, and awarded and executed bilateral contracts that same day. The identity of each bidder is kept confidential because this information is subject to a confidentiality commitment made to the bidders by PG&E as part of the RFO.

The terms and conditions of firm long-term offers received by PG&E covered only the following products: flat and on-peak power delivery (please see term definitions in Attachment B). Terms ranged from one year to five years, and prices ranged from $40.25/MWh to $94/MWh.

Bilateral contracts

Q1. Please provide in detail the terms and conditions of the bilateral contracts into which PG&E entered following the CPUC August 3 order. Please provide the Committee copies of those contracts.

All contracts contain explicit provisions for Pacific Gas and Electric Company to maintain the confidentiality of the bidders, as well as the specific terms and conditions of the contracts. For this reason, PG&E is not providing the identity of any contracting party and is providing the other contract information in tabular form with the understanding that this information will be treated by the recipient as confidential.

PG&E executed long-term contracts for 900 MW for flat and on-peak firm power. Contract terms ranged from 2.5 years to five years. Prices for all contracts were below $66/MWh. Table 3 provides information regarding these contracts. In addition, PG&E entered into numerous short-term (under one year) bilateral contracts on an on-going basis. Information concerning those contracts is provided in Table 2.

Q2. Is your contention that you were prevented from entering into long-term contracts by the CPUC failure to pre-approve contracts contradicted by the fact that PG&E did enter into some contracts following the August 3 order?

Pacific Gas and Electric Company was not prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts. However, the CPUC's August 3, 2000, decision required PG&E to do so under criteria that had been agreed to in advance between PG&E and CPUC staff. The staff's refusal to agree to appropriate pricing benchmarks pursuant to the CPUC's August 3 decision, and the CPUC's own subsequent refusal to approve criteria submitted by PG&E in an attempt to bypass the staff's inaction on this issue, significantly hindered PG&E from rapidly moving forward and contracting for bilateral contracts.

Without approved criteria, PG&E was placed into an untenable situation of either not moving ahead with bilateral contracts to provide price stability for its customers and to hedge against future price spikes, or to move forward and face potentially significant reasonableness risk for up to five years. PG&E believes its bilateral contracts are reasonable and should be deemed so by the CPUC under a reasonableness review, but PG&E has little confidence of receiving fair treatment in a potentially politicized environment created by the energy crisis and the enormous undercollection accrued by PG&E from May 2000 through January 15, 2001. PG&E's decision to eventually execute some bilateral contracts without CPUC-approved reasonableness standards was based on its belief that it was the right thing to do despite the potential monetary risk entailed in so doing.

PG&E had been diligently working with CPUC staff from August 2000 and continued to work with CPUC staff to try to reach agreement on reasonableness standards before executing contracts on October 11, 2000. At best, PG&E has received mixed signals from CPUC staff and the Commissioners themselves, with expressed opinions including: (a) PG&E should not enter into any long-term contracts, (b) the CPUC believes that after-the-fact reasonableness reviews are appropriate for these contracts, despite the clear wording of the August 3 decision, and (c) long-term contracts make sense and should be reasonable. This range of oral opinions, coupled with the CPUC's unwillingness to state criteria officially to guide the contracting process, made it extremely difficult for PG&E to proceed down any path with certainty.

Nonetheless, given the magnitude of the exposure to price volatility, PG&E believed that it was imperative to enter into bilateral contracts without further delay. As of October 11, 2000, the CPUC staff still declined to endorse PG&E moving forward with its bilateral contract solicitation, was unable to find that PG&E's proposed methodology for identifying an appropriate price benchmark was reasonable, and offered no suggestions or alternatives.

Even after the solicitation results were shared with CPUC staff, the staff was not willing to agree to any reasonableness standards. PG&E continued to seek CPUC clarification regarding bilateral purchase reasonableness standards and was prepared to enter into additional long-term contracts. However, prices for five year contracts began to exceed $100/MWh later in the year, which, given the probability that the energy crisis would abate over time, posed significant reasonableness risk for the out years in the contracts given the absence of any clear reasonableness standards by the CPUC. That is, without the protection of reasonableness criteria that PG&E could meet in the marketplace, lower energy prices in the later years of a five-year contract would simply permit the CPUC to disallow substantial amounts of the contract costs based on after-the-fact reasonableness reviews that disregard the market dynamics at the time. PG&E was unwilling to accept that greater financial risk and did not enter into contracts at these higher prices. In addition, PG&E's financial condition had deteriorated by mid-December to the point that credit terms for long-term bilateral contracts were impossible for PG&E to meet.

Q3. What is your interpretation of the CPUC's "reasonableness" standards?

To this date, the CPUC has not adopted any reasonableness standards for bilateral contracts. In the absence of such standards, Pacific Gas and Electric Company believes it likely will face an after-the-fact review by the CPUC of the contracts that is based on the then-prevailing environment, rather than a fair review of the market conditions at the time the contracts were entered.

Prior to its August 3 decision, the CPUC conducted reasonableness reviews after-the-fact, often a year or more after the end of an operating year. These reviews did not follow preset standards, but rather were open-ended proceedings based on what the CPUC concluded, with hindsight and in the context of current conditions, that PG&E should have done. Such reasonableness reviews would create unacceptably large cost recovery risk for PG&E during periods of significant market change, such as have characterized the energy crisis in California since last summer.

The August 3 order approved PG&E's proposal for <u>prospective</u> reasonableness standards. The order said:

> [W]e find the proposed reasonableness standards of PG&E acceptable for near and interim purchases subject to the quantity restrictions previously adopted. Under PG&E's proposed standard, PG&E will identify for the Energy Division and the Office of Ratepayer Advocates, ahead of time the specific sources of prices offered in the market for energy, ancillary services and capacity products that will be used to price the bilateral transactions. These identified sources will provide a target price range for PG&E's contracts. Any purchases made by PG&E within this approved range will be reasonable per se. In addition, as PG&E enters into new bilateral purchases, PG&E will similarly identify a price range for

the specific products being procured. The Energy Division and ORA will be able to validate the price range based on the same market price sources identified ahead of time.

To expedite approval of prospective reasonableness standards, on October 16, 2000, PG&E proposed specific reasonableness standards before entering into additional bilateral contracts. Unfortunately, the CPUC has failed to act on this filing.

Confusing the issue even further, the CPUC has since sought to modify its August 3 order. On December 22, 2000, the CPUC requested comments on proposed clarifications and modifications to the reasonableness standards of the August 3 order. Those standards would find any contracts up to years in duration to be reasonable if prices were between $50-60/MWh. This price cap on reasonableness was issued by the Commission during a period when five-year contracts exceeded $100/MWh, making it impossible for PG&E to enter into any such contracts without the significant financial exposure represented by the $40-50/MWh differential.

On January 18, 2001, the CPUC proposed: a) another set of standards; and b) a new set of "portfolio benchmarks." PG&E expressed concerns that these proposals were unworkable in written comments filed with the CPUC. In conclusion, it is difficult for PG&E to predict how the CPUC will interpret its own August 3 approval of reasonableness standards for bilateral contracts, and, in any case, the CPUC has yet to provide any such guidance.

Q4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

The CPUC's failure to provide clear and useful reasonableness standards created uncertainty about the recovery of forward purchase costs, and hindered PG&E from entering into long-term purchases earlier and for larger contract amounts.

Stranded Costs

Q1. Does PG&E consider the TURN Proposal a more appropriate standard?

No, Pacific Gas and Electric Company considers the TURN Proposal to be an illegal change to the rules of the transition period after PG&E had already recovered its transition costs and contrary to provisions of AB 1890. By way of background, when the restructuring law was implemented the CPUC established two accounts for the utilities to track revenue collection during the transition to a competitive market. The Transition Cost Balancing Account (TCBA) is used to track the recovery of utilities' stranded costs and the Transition Revenue Account (TRA) is used to match the amount of the billed revenues against various costs associated with providing service including transmission, distribution, generation and public purpose charges.

Until the TURN Proposal was adopted, the balance in the TRA was transferred to the TCBA at the end of each month. The Commission ruled in 1998 that only positive balances were to be transferred, reasoning that if negative balances were allowed into the TCBA, effectively they would become transition costs, eligible for stranded cost recovery, inconsistent with provisions of AB 1890. During the first years of the transition, when utilities had excess revenues, they used them to write down the transition costs. Once a transition cost was written down, it could not reappear on the books. If the utilities did not have excess revenue one month, no transitions costs were paid that month; the amount of transition costs to be collected was not increased.

The TURN Proposal changed the Commission's 1998 decision and would allow negative balances to be transferred from the TRA to the TCBA, essentially increasing the transition costs to be recovered. The effect of the accounting change is to make it appear as if PG&E has not recovered its transition costs. During hearings on the proposal, TURN's witness stated that "under the TURN accounting proposal, there are NO (zero) unrecovered purchase power costs; only unrecovered transition costs." In fact, the Commission itself acknowledged this effect, saying the utilities "have not recovered all of their stranded costs under any scenario put forth by any party, given these accounting adjustments [*i.e.*, the adoption of the TURN accounting proposal, which completely reverses the rules for measuring transition cost recovery]."[1/]

Q2. Some have argued that the accounting change is a regulatory taking of assets. What are the views of PG&E on this subject?

Pacific Gas and Electric Company agrees that the TURN Proposal results in an unconstitutional taking of PG&E's assets.

The accounting change in the TURN Proposal makes it appear that PG&E has not recovered its transition costs. Under AB 1890, the rate freeze stays in effect until transition costs are recovered or until March 31, 2002, whichever occurs earlier. Because the accounting changes make it impossible for PG&E to recover its transition costs, frozen rate levels keep rates that are clearly below the authorized cost of service. The United States Supreme Court has ruled that rates must be set at a level that allows the utility a reasonable opportunity to recover its costs of service. If the rate does not afford sufficient compensation, the state has taken the use of the utility property without paying just compensation and so violates the Fifth and Fourteenth Amendments of the U.S. Constitution.

Rewriting the accounting rules after the fact makes it appear that PG&E has recovered procurement costs and failed to recover transition costs. This is significant because under the federal Filed Rate Doctrine the CPUC is required to allow PG&E to recover from ratepayers federally approved wholesale power costs. By offsetting the procurement costs against the transition costs, the CPUC is attempting to preclude PG&E from

1/ Accounting Reversal Decision, mimeo at p. 20.

recovering its procurement costs. This results in a taking of PG&E's property without just compensation.

Further, the TURN Proposal's effect is to require PG&E to forgo its already collected transition costs to pay for power procurement costs. Because there is no apparent means of recovering the costs transferred into the TCBA, a taking has clearly occurred.

Q3. How does the TURN Proposal affect the Transitional Recovery Account (sic) and the Transition Cost Balancing Account?

As described above, prior to the Commission's adoption of the TURN Proposal, any revenues accrued in the Transition Revenue Account (TRA) were transferred monthly to the Transition Cost Balancing Account (TCBA), but negative balances were not allowed to be transferred from the TRA to the TCBA. Previously, any revenues in the Generation Memorandum Accounts (set up to track the ongoing costs for the utilities' retained generation and market revenues from sales from those plants into the power exchange) were also transferred to the TCBA to offset transition costs.

The TURN Proposal changes CPUC accounting rules so that uncollected costs in the TRA are transferred monthly into the TCBA. In addition, above market generation revenues accumulated in the Generation Memorandum Accounts are transferred to the TRA instead of the TCBA. The effect of this change in the accounting rules is that (1) the growing deficit in the TRA due to the high costs of procuring power on behalf of our customers depletes the revenue already collected to recover transition costs, and (2) procurement costs are converted into transition costs that have no chance of recovery by the statutory end of the transition period (i.e., March 31, 2002).

Q4. With this new accounting procedure, will PG&E be able to collect against its stranded costs as envisioned in AB 1890.

The TURN Proposal makes it unlikely, if not impossible, that Pacific Gas and Electric Company could fully recover its stranded costs, absent a favorable outcome to PG&E's various legal challenges to the CPUC's prior interpretations of AB 1890. The only source of recovery of transition costs remaining (after the elimination of headroom given the current level of power costs, and the CPUC's actions transferring revenues derived from sales of generation at market rates from being used to pay down transition costs to, instead, paying down procurement costs) would be from the market valuation of utility retained generation, as required by AB 1890. However, it is unlikely that the aggregate market value of PG&E's retained non-nuclear assets would exceed the outstanding uncollected stranded costs.

<u>FERC's Market Mitigation Plan</u>

Q1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

FERC's plan imposes price mitigation for real-time sales during emergency periods of reserve deficiency (i.e., when generation reserves are 7.5 percent or less). While this approach may partially limit prices and represents a good first step toward mitigation, it will not ensure just and reasonable rates generally unless it is modified to: (1) apply to all hours, not just emergency conditions, (2) address and restrain prices in the forward market, and (3) use reasonable inputs for determining proxy prices rather than relying on the least efficient generator, gas purchased only in the spot market, and high priced emission credits. Also, as discussed in Question 4 below, the plan should apply to the entire market, in this case the entire Western States Coordinating Council (WSCC) region.

Q2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

The extent of any blackouts in California this summer is dependent on a number of factors, including temperature and rainfall, which cannot be fully known ahead of time. However, the fundamental problem leading to blackouts -- the current imbalance between supply and demand -- can only be resolved on a long-term basis and is currently being addressed in a number of forums (e.g., streamlining of siting approvals, energy efficiency and demand reduction program designs, financial incentives for transmission upgrades).

FERC's mitigation plan takes certain steps to address this supply and demand imbalance through must-sell requirements, encouraging demand response, and the coordination and control of generation outages. However, in the short term, these measures will make only a minor contribution to the supply insufficiency, and until significant additional generation capacity is brought online, FERC must focus on protecting consumers against prices that exceed just and reasonable levels.

Q3. Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?

FERC's plan requires that all in-state generators offer available capacity to the California ISO in real time. With respect to the WSCC, the plan merely proposes that all available capacity be offered for sale in real time anywhere in the West. Under either approach, out-of-state generators are free to choose where to sell their real-time power, and they clearly will not choose markets where they are financially disadvantaged in some way. Thus, to the extent that only California sales are subject to price mitigation (as is currently the case), FERC's plan could discourage out-of-state generators from selling into California.

If mitigation is applied comprehensively across the West, such a plan would not discourage sales into California.

Q4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Market mitigation can be effective only if it encompasses the entire affected market. The Western grid is fully interconnected, and the region has a long history of wholesale power exchanges and mutual reliance. Right now, the entire Western region of the United States is facing a serious shortage of electricity supplies at the same time that demand for power has increased significantly. Various circumstances including unanticipated load growth, weather conditions, and low water reserves for hydroelectric generation have led to capacity concerns throughout the WSCC region. Moreover, the high level of energy trades across state boundaries in the West causes market imperfections to be felt across state boundaries as well. As a result, prices for this essential commodity are so high that the economic and social well being of the entire region is threatened. A regional mitigation plan can address the interconnected nature of the Western electricity market and prevent buyers from bidding up energy prices as they seek to meet inelastic demand and avoid curtailing their customers.

Q1. Do you believe that municipalities and PMA's will have to abide by the market mitigation plan?

A problem arises with requiring these entities to abide by the mitigation plan because they are not directly subject to FERC's jurisdiction. Nevertheless, FERC makes creative use of its limited existing jurisdiction to compel compliance. FERC requires that, "as a condition of using the ISO's open access interstate transmission tariff which is subject to this Commission's exclusive jurisdiction, all sellers of energy that own or control generators in California, including non-public utilities, whose power is transmitted over the ISO-controlled interstate transmission facilities, must abide by the same must-offer obligation and the price mitigation plan" as jurisdictional entities. While many municipalities can be expected to challenge this use of FERC's jurisdiction, FERC previously has adopted reciprocity requirements as part of its open access policies, and the market mitigation conditions can be viewed, generally, as extension of this policy.

PG&E would note that this problem could be addressed by legislation that gives FERC the necessary jurisdiction over these entities.

Q2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

FERC allows marketers to either accept the market clearing proxy price or submit their own bid. If their bid exceeds the market clearing price, they would be required to justify the bid based on the prices they paid for power. As the Commission recognized, marketers generally have portfolios of energy supplies, which may have been acquired from other marketers, so that the same megawatt has been sold many times. Thus, marketers have the ability to buy power either in the day-ahead market or in longer-term forward contracts and then resell such power to other marketers who, in turn, can sell to yet another marketer. Such multiple sale transactions can increase prices exponentially because each transaction provides the opportunity for significant mark-ups.

Q3. Will the plan protect consumers from megawatt laundering?

The current plan provides no substantive response to this problem. "Megawatt laundering" refers to the practice where an in-state supplier schedules supply out-of-state and then reimports that power to avoid a mitigated price. Several commenters voiced concern about this practice in FERC's proceeding. In response, the Commission instituted an investigation into public utility sales for resale in the WSCC.

Attachment A

(E-mail sent by Pacific Gas and Electric Company, vice-president – human resources, Wednesday, April 11, 2001)

Officers, Directors, and Department Heads:

Our April 6, 2001, filing for reorganization under Chapter 11 of the U. S. Bankruptcy Code has impacted many parts of our business. In conjunction with our bankruptcy filing, we asked for authorization to continue our employee compensation and benefit programs. Described below is our current understanding of how we will administer many of our HR programs in light of the Court's favorable ruling granting our request.

Compensation

- Employee paychecks for regular and over-time will continue uninterrupted.
- Un-cashed paychecks are still valid and should be honored by all financial institutions. If an employee has a problem, they should contact the Payroll helpline at 223-3767.
- Business expenses incurred by employees both before and after our April 6 filing will be reimbursed under the normal procedures consistent with USP 10.
- Employee meal expenses will continue to be reimbursed under the normal procedures.
- Un-cashed employee expense account checks and meal payments are still valid and should be honored by all financial institutions. If an employee has a problem they should contact Payables at 223-PAID (223-7243).

Benefits

- Health benefits under existing policies (FLEX and non-FLEX) continue uninterrupted.
- Qualified pension benefits under the Retirement Plan continue uninterrupted.

- Retirement Savings Plan and Savings Fund Plan (i.e. 401k plans) continue uninterrupted. Company matching contributions in the both Plans will also continue.

- Tuition Refund Plan continues uninterrupted. All existing tuition refund vouchers continue to be valid.

- Employees will have all accrued vacation available for their use.

Other

- Collective bargaining agreements remain in effect.

- The Company continues to recruit and hire new employees to fill current vacancies throughout the organization, and will continue to do so in anticipation of attrition.

The information above is based on our current understanding of the judge's ruling. We will review other programs to resolve issues as they arise. As information becomes available, we will provide you with updates. Unless otherwise indicated above, employees with questions should contact their HR Advisor.

As you can see, one of the primary actions we took as part of our Chapter 11 filing was to ask for Bankruptcy Court permission to honor our ongoing employee pay and benefit obligations. We strongly believe a dedicated workforce, that is paid competitively, is crucial to our success today and in the future. We are extremely gratified the Court also recognizes the important contributions that our employees have made, and will continue to make.

Please feel free to share this message with employees in your respective organizations.

Russ Jackson

Attachment B

Definition of Terms
Tables 1-3

Delivery Points

- NP15: North of Path 15. Path 15 is a transmission corridor in central California
- COB: California – Oregon Border

Product

- Flat: Power delivered at a constant delivery rate for a 24 hour period
- On-Peak: Power delivered during the peak use period, 7:00 AM to 10:00 PM
- Off-Peak: Power delivered during the off peak use period, 10:00 PM to 7:00 AM
- Combined: Combination of the above periods.

Type

- Interruptible: Power delivery can be interrupted at the discretion of the buyer or seller.
- Firm: Power supply is not subject to interruption.

Pacific Gas and Electric Company

Dede Hapner
Vice President
Regulatory Relations

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July 6, 2001

The Honorable Dan Burton
Chairman, Committee on Government Reform
United States House of Representatives
Washington, DC 20515

Dear Chairman Burton:

This letter is in response to your letter of July 2, 2001, requesting additional information from Pacific Gas and Electric Company (PG&E) regarding bilateral contracts entered into with energy producers during 2000. Attached please find the following information:

- Table 1: Summary of Proposals Received Pursuant to PG&E's October 11, 2000, Request for Offers
- Table 2: Summary of Short-term Bilateral Transactions from September 2000 through January 2001
- Table 3: Summary of Long-term Contracts Accepted on October 11, 2000
- Attachment A: Definition of Terms

All contracts contain explicit provisions for PG&E to maintain the confidentiality of the bidders, as well as the specific terms and conditions of the contracts. For this reason, we are not providing the identity of any contracting party and are providing contract information in tabular form.

Following the California Public Utility Commission's August 3, 2000, decision allowing the utilities to enter into bilateral contracts, PG&E issued a request for offers (RFO) in September, with bids to be accepted on October 11, 2000. PG&E requested bidders to provide energy offers for up to five years. Table 1 provides information regarding all bids submitted by producers in October 2000. PG&E accepted final bids on October 11, 2000, and awarded and executed bilateral contracts that same day.

PG&E executed long-term contracts for 900 MW for flat power (delivered at a constant rate, 24-hours a day) and on-peak firm power (delivered from 7:00 a.m. to 10:00 p.m.). Contract terms ranged from 2.5 to five years and prices for all contracts were below \$66/MWh. Table 3 provides information regarding these contracts. In addition, PG&E entered into numerous short-term (under one year) bilateral contracts. Information concerning those contracts is provided in Table 2.

The Honorable Dan Burton
July 6, 2001
Page 2

We appreciate the efforts of the committee to investigate and develop solutions to the energy crisis now encompassing the state of California and the West. We are committed to continue working with you in any way possible to find such solutions.

Please let us know if we can provide any additional information.

Sincerely,

Dede Hapner

Attachments

cc: The Honorable Doug Ose	(w/o attachments)
The Honorable John Tierney	(" ")
The Honorable Henry Waxman	(" ")

CONFIDENTIAL

Table 1

Pacific Gas and Electric Company

Summary of Proposals Received Pursuant to PG&E's October 11, 2000 Request for Offers

Counterparty	Quantity (MW)	Delivery Point	Price ($/MWh)	Term	Product	Type
A	50 [1]	NP15	78.75	Jan01-Dec01	On-Peak	Firm
A	50 [1]	NP15	61.25	Jan02-Dec02	On-Peak	Firm
A	50 [1]	NP15	51.50	Jan03-Dec03	On-Peak	Firm
A	50 [1]	NP15	48.25	Jan04-Dec04	On-Peak	Firm
A	50 [1]	NP15	44.75	Jan05-Dec05	On-Peak	Firm
A	50 [1]	NP15	79.25	Jan01-Dec01	On-Peak	Firm
A	50 [1]	NP15	61.75	Jan02-Dec02	On-Peak	Firm
A	50 [1]	NP15	52.00	Jan03-Dec03	On-Peak	Firm
A	50 [1]	NP15	48.75	Jan04-Dec04	On-Peak	Firm
A	50 [1]	NP15	45.25	Jan05-Dec05	On-Peak	Firm
A	50 [1]	NP15	80.25	Jan01-Dec01	On-Peak	Firm
A	50 [1]	NP15	62.75	Jan02-Dec02	On-Peak	Firm
A	50 [1]	NP15	53.00	Jan03-Dec03	On-Peak	Firm
A	50 [1]	NP15	49.75	Jan04-Dec04	On-Peak	Firm
A	50 [1]	NP15	46.25	Jan05-Dec05	On-Peak	Firm
A	50 [1]	NP15	65.00	Jan01-Dec03	On-Peak	Firm
A	50 [1]	NP15	65.50	Jan01-Dec03	On-Peak	Firm
A	50 [1]	NP15	66.50	Jan01-Dec03	On-Peak	Firm
A	50 [1]	NP15	59.00	Jan01-Dec05	On-Peak	Firm
A	50 [1]	NP15	59.50	Jan01-Dec05	On-Peak	Firm
A	50 [1]	NP15	60.50	Jan01-Dec05	On-Peak	Firm
B	50	NP15	92.50	Nov00-Nov00	On-Peak	Firm
B	50	NP15	94.50	Dec00-Dec00	On-Peak	Firm
B	50	NP15	94.00	Jan01-Dec01	On-Peak	Firm
C	50 up to 500	NP15	86.00	Nov00-Nov00	On-Peak	Firm
C	50 up to 500	NP15	86.00	Dec00-Dec00	On-Peak	Firm
C	50 up to 500	NP15	86.00	Jan01-Dec01	On-Peak	Firm
D	50	NP15	84.00	Nov00-Nov00	On-Peak	Firm
D	50	NP15	83.00	Dec00-Dec00	On-Peak	Firm
D	50	NP15	64.19	Jan01-Dec03	On-Peak	Firm
D	50	NP15	58.00	Jan01-Dec05	On-Peak	Firm
E	50	NP15	59.50	Jan01-Dec05	On-Peak	Firm
E	50	NP15	67.75	Jan01-Dec03	On-Peak	Firm
F	50 [2]	NP15	64.50	Jan01-Dec03	On-Peak	Firm
F	50 [2]	NP15	65.00	Jan01-Dec03	On-Peak	Firm
F	50 [2]	NP15	58.40	Jan01-Dec05	On-Peak	Firm
F	50 [2]	NP15	58.70	Jan01-Dec05	On-Peak	Firm
A	50 [1]	NP15	69.00	Jan01-Dec01	Flat	Firm
A	50 [1]	NP15	69.50	Jan01-Dec01	Flat	Firm
A	50 [1]	NP15	70.50	Jan01-Dec01	Flat	Firm
A	50 [1]	NP15	53.25	Jan02-Dec02	Flat	Firm
A	50 [1]	NP15	53.75	Jan02-Dec02	Flat	Firm
A	50 [1]	NP15	54.75	Jan02-Dec02	Flat	Firm
A	50 [1]	NP15	45.75	Jan03-Dec03	Flat	Firm
A	50 [1]	NP15	46.25	Jan03-Dec03	Flat	Firm
A	50 [1]	NP15	47.25	Jan03-Dec03	Flat	Firm
A	50 [1]	NP15	43.00	Jan04-Dec04	Flat	Firm
A	50 [1]	NP15	43.50	Jan04-Dec04	Flat	Firm
A	50 [1]	NP15	44.50	Jan04-Dec04	Flat	Firm
A	50 [1]	NP15	40.25	Jan05-Dec05	Flat	Firm
A	50 [1]	NP15	40.75	Jan05-Dec05	Flat	Firm
A	50 [1]	NP15	41.75	Jan05-Dec05	Flat	Firm
A	50 [1]	NP15	57.00	Jan01-Dec03	Flat	Firm

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Table 1

Pacific Gas and Electric Company

Summary of Proposals Received Pursuant to PG&E's October 11, 2000 Request for Offers

Counterparty	Quantity (MW)		Delivery Point	Price ($/MWh)	Term	Product	Type
A	50	[1]	NP15	57.50	Jan01-Dec03	Flat	Firm
A	50	[1]	NP15	58.50	Jan01-Dec03	Flat	Firm
A	50	[1]	NP15	52.00	Jan01-Dec05	Flat	Firm
A	50	[1]	NP15	52.50	Jan01-Dec05	Flat	Firm
A	50	[1]	NP15	53.50	Jan01-Dec05	Flat	Firm
G	200		NP15	51.50	Jul01-Dec03	Flat	Firm
G	200		NP15	51.50	Jul01-Dec03	Flat	Firm
B	50		NP15	86.75	Nov00-Nov00	Flat	Firm
B	50		NP15	88.00	Dec00-Dec00	Flat	Firm
B	50		NP15	82.25	Jan01-Dec01	Flat	Firm
D	50		NP15	56.75	Jan01-Dec03	Flat	Firm
D	50		NP15	51.50	Jan01-Dec05	Flat	Firm
E	50		NP15	52.50	Jan01-Dec05	Flat	Firm
E	50		NP15	59.25	Jan01-Dec03	Flat	Firm
H	100		NP15	83.00	Nov00-Nov00	Flat	Firm
H	100		NP15	84.00	Dec00-Dec00	Flat	Firm
H	100		NP15	74.00	Jan01-Dec01	Flat	Firm
H	100		NP15	53.11	Jan02-Dec02	Flat	Firm
H	100		NP15	45.07	Jan03-Dec03	Flat	Firm
H	100		NP15	42.11	Jan04-Dec04	Flat	Firm
H	100		NP15	40.60	Jan05-Dec05	Flat	Firm
F	50	[2]	NP15	56.00	Jan01-Dec03	Flat	Firm
F	50	[2]	NP15	56.75	Jan01-Dec03	Flat	Firm
F	50	[2]	NP15	50.90	Jan01-Dec05	Flat	Firm
F	50	[2]	NP15	51.45	Jan01-Dec05	Flat	Firm

Footnotes

[1] At Seller's option, total quantity of energy offered to PG&E under all the proposal transactions is limited to 250 MW.

[2] Up to 100 MW total.

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Table 2

Pacific Gas and Electric Company

Summary of Short-term Bilateral Transactions From September, 2000 through January, 2001

Purchase Date	Counterparty	Quantity (MW)	Delivery Point	Price ($/MWh)	Month	Year	Product	Type
September								
19-Sep	K	50	COB	120.00	Oct-00	2000	Peak	Firm
19-Sep	K	25	COB	91.00	Oct-00	2000	Off-Peak	Firm
21-Sep	L	50	COB	101.00	Oct-00	2000	Flat	Firm
26-Sep	M	75	NP15	95.00	Nov/Dec-00	2000	Peak	Firm
October								
3-Oct	N	50	NP15	96.90	Dec-00	2000	On-Peak	Firm
3-Oct	O	25	NP15	84.50	Cal 2001	2001	On-Peak	Firm
4-Oct	O	25	NP15	84.15	Cal 2001	2001	On-Peak	Firm
11-Oct	P	75	NP15	82.00	Nov-00	2000	On-Peak	Firm
16-Oct	Q	25	NP15	85.50	Dec-00	2000	On-Peak	Firm
17-Oct	P	50	NP15	85.00	Nov-00	2000	On-Peak	Firm
17-Oct	P	50	NP15	71.50	Nov-00	2000	On-Peak	Firm
17-Oct	P	25	NP15	83.00	Dec-00	2000	On-Peak	Firm
18-Oct	Q	25	NP15	72.00	Dec-00	2000	Off-Peak	Firm
19-Oct	R	100	NP15	78.50	Nov/Dec-00	2000	Flat	Firm
24-Oct	P	75	NP15	82.25	Dec-00	2000	On-Peak	Firm
24-Oct	S	25	NP15	69.25	Q1 -01	2001	On-Peak	Firm
25-Oct	Q	50	NP15	86.00	Dec-00	2000	On-Peak	Firm
25-Oct	Q	25	NP15	76.00	Dec-00	2000	Off-Peak	Firm
26-Oct	Q	25	NP15	90.00	Nov-00	2000	On-Peak	Firm
26-Oct	Q	50	NP15	90.25	Nov-00	2000	On-Peak	Firm
26-Oct	Q	25	NP15	80.00	Nov-00	2000	Off-Peak	Firm
26-Oct	Q	50	NP15	81.50	Nov-00	2000	Off-Peak	Firm
26-Oct	Q	25	NP15	79.50	Dec-00	2000	Off-Peak	Firm
26-Oct	P	25	NP15	81.50	Nov-00	2000	Off-Peak	Firm
26-Oct	P	25	NP15	90.00	Nov-00	2000	On-Peak	Firm
27-Oct	Q	25	NP15	79.00	Nov-00	2000	On-Peak	Firm
November								
7-Nov	Q	50	NP15	76.25	Dec-00	2000	Off-Peak	Firm
8-Nov	Q	25	NP15	97.75	Dec-00	2000	ON-PEAK	Firm
14-Nov	Q	50	NP15	92.50	Dec-00	2000	Off-Peak	Firm
15-Nov	Q	25	NP15	91.50	Dec-00	2000	Off-Peak	Firm
15-Nov	Q	25	NP15	91.50	Dec-00	2000	Off-Peak	Firm
21-Nov	Q	25	NP15	165.00	Dec-00	2000	On-Peak	Firm
21-Nov	Q	50	NP15	214.00	Nov 27-30	2000	On-Peak	Firm
21-Nov	Q	50	NP15	158.00	Dec-00	2000	On-Peak	Firm
22-Nov	Q	25	NP15	194.00	Dec-00	2000	On-Peak	Firm
22-Nov	Q	25	NP15	165.00	Dec-00	2000	On-Peak	Firm

December

No trades. However, PG&E did convert a trade from the Block Forward Market (BFM)to the bilateral market on December 29, 2000, by selling it on the BFM and buying the same quantity at the same price and term in the bilateral market. This conversion was with Party X for 25 MW of firm on-peak power, delivered to NP15 for first quarter 2001, at a price of $53.50/MWh. PG&E originally bought this trade in the BFM on July 11, 2000. There was no gain or loss since the sale and purchase price were equal. This conversion allows PG&E to preserve the hedge value of the original trade by reducing the amount of power PG&E would have otherwise needed to purchase in the PX or CAISO markets.

January

No trades. However, PG&E did convert a trade from the Block Forward Market (BFM)to the bilateral market on January 17, 2001, by selling it on the BFM and buying the same quantity at the same price and term in the bilateral market. This conversion was with Party Y for 25 MW of firm on-peak power, delivered to NP15 for third quarter 2001, at a price of $130.00/MWh. PG&E originally bought this trade in the BFM on August 17, 2000. There was no gain or loss since the sale and purchase price were equal. This conversion allows PG&E to preserve the hedge value of the original trade by reducing the amount of power PG&E would have otherwise needed to purchase in the PX or CAISO markets.

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Table 3

Pacific Gas and Electric Company

Summary of Long Term Contracts
Accepted on October 11, 2000*

Counterparty	Quantity (MW)	Delivery Point	Price ($/MWh)	Term	Product	Type
R	400	Various [1]	51.50	Jul 1, 2001 - Dec 31, 2003	Flat	Firm
S	50	NP15	64.19	Jan 1, 2001 - Dec 31, 2003	On-Peak	Firm
T	50	NP15	65.00	Jan 1, 2001 - Dec 31, 2003	On-Peak	Firm
U	50	NP15	58.40	Jan 1, 2001 - Dec 31, 2005	On-Peak	Firm
V	50	NP15	65.50	Jan 1, 2001 - Dec 31, 2003	On-Peak	Firm
U	50	NP15	58.70	Jan 1, 2001 - Dec 31, 2005	On-Peak	Firm
T	50	NP15	57.00	Jan 1, 2001 - Dec 31, 2003	Flat	Firm
T	50	NP15	59.00	Jan 1, 2001 - Dec 31, 2005	On-Peak	Firm
T	50	NP15	57.50	Jan 1, 2001 - Dec 31, 2003	Flat	Firm
T	50	NP15	59.50	Jan 1, 2001 - Dec 31, 2005	On-Peak	Firm
V	50	NP15	59.50	Jan 1, 2001 - Dec 31, 2005	On-Peak	Firm

Footnotes
[1] Various locations within Zone NP15.
* Long term, large block hedge products accapted on
October 11, 2000 pursuant to PG&E's Request for Offers

Attachment A

Definition of Terms
Tables 1-3

Delivery Points

- NP15: North of Path 15. Path 15 is a transmission corridor in central California
- COB: California – Oregon Border

Product

- Flat: Power delivered at a constant delivery rate for a 24 hour period
- On-Peak: Power delivered during the peak use period, 7:00 AM to 10:00 PM
- Off-Peak: Power delivered during the off peak use period, 10:00 PM to 7:00 AM
- Combined: Combination of the above periods.

Type

- Interruptible: Power delivery can be interrupted at the discretion of the buyer or seller.
- Firm: Power supply is not subject to interruption.

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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www.house.gov/reform

May 16, 2001

Mr. Stephen Pickett
Vice President and General Counsel
Southern California Edison
2244 Walnut Grove Avenue
Rosemead, CA 91770

Dear Mr. Pickett:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 11 in San Jose. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Transfers to Parent Corporations:

At the April 11 hearing, several Members requested that Pacific Gas and Electric (PG&E) and Southern California Edison (SCE) provide information on profits generated and funds transferred to parent companies. For instance, Congresswoman Lofgren asked:

> *"Does Southern California Edison have a parent corporation? ... And were there transfers of funds to the parent corporation from you all as well?"*

You responded in the affirmative, and stated:

> *"I do not know the dollar amount off the top of my head. We can get it and supply it to the Committee."*

You added that there are three categories of allowable transfers from regulated utilities to their parent companies: 1.) dividends of earnings 2.) payments of taxes and 3.) special dividends.

Mr. Stephen Pickett
Page 2

Please respond to the following questions:

1. What was SCE's net income and return on assets in 1999 and 2000?

2. What was SCE's net income and return on assets for the first three months of 2001?

3. How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?

4. For each of the three categories of allowable transfers listed above, please specify how much money SCE transferred to its parent company in 1999 and 2000.

5. For each of the three categories of allowable transfers listed above, please specify how much money SCE has transferred to its parent company during the first three months of 2001.

Long-Term Contracts:

There have been numerous press reports that the investor-owned utilities in California received offers of long-term contracts at five cents per kilowatt hour in the summer of 2000. On April 11, you were asked if SCE had received such offers during that time period, and what rates were offered. You responded:

> *"I do not have the exact number. We can get the numbers that were made available to us and present them to you, if it is of benefit to the Committee. We found, as PG&E apparently did, that a number of generators made offers, usually through the press, not directly to us, that they were willing to sell us power, a figure that was tossed around in the early or late spring, early summer of last year was five cent power."*

You added:

> *"It proved, on investigation, not to be the fact. The terms of the contracts would have ultimately made them substantially more expensive."*

Please respond to the following question:

1. Please describe in detail the terms and conditions of the long-term contract proposals received by SCE in the summer of 2000.

Bilateral Contracts

At both the April 10 and April 11 hearings, there was a great deal of discussion about the California Public Utilities Commission's August 3, 2000, order allowing regulated utilities to enter into bilateral contracts. The discussion centered around whether that order granted the utilities sufficient authority to lock in relatively low long-term rates before the market exploded.

On April 10, CPUC President Loretta Lynch testified that:

> *"On a unanimous vote two weeks after the utilities asked for the authority to enter into bilateral contracts, the PUC did give the utilities the authority to enter into bilateral contracts, and then they entered into bilateral contracts. I am prevented, for confidentiality reasons, from telling the public exactly what they entered into, but I can tell you they entered into significant bilateral contracts."*

On April 11, you stated that SCE did in fact sign five bilateral contracts totalling 350 megawatts of power following the CPUC's August 3 order. While you did not at the time have the details of those contracts, you offered to provide them to the Committee. Please respond to the following questions and requests for information:

1. Please describe in detail the terms and conditions of the bilateral contracts into which SCE entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.

2. Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that SCE did in fact enter into some contracts following the August 3 order?

3. What is your interpretation of the CPUC's "reasonableness" standards?

4. How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?

Stranded Costs

The CPUC recently changed certain regulatory accounting principles for the investor-owned utilities that were agreed upon in 1998. This change has been referred to as the "TURN Proposal." Please respond to the following questions:

1. Does SCE consider the TURN Proposal a more appropriate standard?

2. Some have argued that the accounting change is a regulatory taking of assets. What are the views of SCE on this subject?

3. How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?

4. With this new accounting procedure, will SCE be able to collect against its stranded costs as envisioned in AB 1890?

FERC's Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Mr. Stephen Pickett
Page 5

Thank you for your continued cooperation in this matter. In order to allow us to complete the hearing record in a timely fashion, please respond by Friday, May 25. If you have any questions, please contact Full Committee Staff Director Kevin Binger at 202-225-5074.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

Cc: The Honorable Henry Waxman
Ranking Minority Member

SOUTHERN CALIFORNIA
EDISON
An EDISON INTERNATIONAL℠ Company

Stephen E. Pickett
Vice President &
General Counsel

RECEIVED
JUN 1 2001
Doug Ose, M.C.
Washington, DC

May 25, 2001

The Honorable Dan Burton, Chairman
House Committee on Government Reform
United States House of Representatives
Washington D.C. 20510

The Honorable Doug Ose, Chairman
Subcommittee on Energy Policy, Natural Resources
and Regulatory Affairs
United States House of Representatives
Washington D.C. 20510

{Via Facsimile and U.S. Mail}

RE: Committee Questions

Dear Chairmen Burton and Ose:

Southern California Edison (SCE) was pleased to provide testimony to the House Committee on Government Reform on April 11, 2001, in San Jose, California. We appreciate this opportunity to provide the Committee with additional details concerning our financial situation, the Federal Energy Regulatory Commission's (FERC) Market Mitigation Plan, power contracting opportunities, and stranded costs.

SCE has provided answers to as many of the Committee's questions as possible prior to your May 25, 2001, deadline. SCE respectfully requests until June 8, 2001, to provide the remaining answers. The Committee's questions are re-stated below in *italics* with my answers directly below each question.

Transfers of Funds to the Parent Corporation

1) *What was SCE's net income and return on assets in 1999 and 2000?*

	1999:	2000:
Net Income	$ 509,421,000	($ 2,028,344,000)
Total Assets	$17,657,306,000	$15,966,096,000
Return on Assets	2.89%	(12.70%)

The net income was calculated before payment of dividends on preferred stock. Total assets are as reported on SCE's consolidated balance sheet and include items not included in utility rate base, i.e., items not charged to our customers in the electric rates they pay SCE. Return on assets is net income divided by total assets.

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2) *What was SCE's net income and return on assets for the first three (3) months of 2001?*

	2001:
Net Income	($592,000,000)
Total Assets	$17,879,000,000
Return on Assets	(13.24%) (Annualized)

3) *How do these figures compare historically to PG&E's net income and return on assets prior to deregulation?*

SCE assumes this question is intended to state "SCE" rather than "PG&E". As such, included below for comparison to Questions 1 and 2 are SCE's net income and return on asset figures for the years 1993 – 1997. SCE assumes "deregulation" began in 1998, when the Power Exchange and the Independent System Operator began operations.

	1993	1994	1995	1996	1997
Net Income	$678	$639	$680	$655	$606
Total Assets	$18,098	$18,076	$18,155	$17,737	$18,059
Return on Assets	3.75%	3.54%	3.75%	3.69%	3.36%

4) *For each of the three (3) categories of allowable transfers [dividends of earnings, payment of taxes, and special dividends], please specify how much money SCE transferred to its parent company in 1999 and 2000.*

A total of $1.8 Billion was transferred from SCE to its parent company, Edison International (EIX), during 1999 and 2000. These monies were used to pay dividends to EIX's shareholders, to pay taxes, to repurchase shares of EIX common stock, and to pay certain miscellaneous expenses. The transfers are discussed by class below:

- Dividends paid to common shareholders: SCE pays dividends to EIX (its only shareholder) that are used to fund EIX common shareholder dividends. For 1999 and 2000, the dividends transferred by SCE to EIX were:
  - 1999: $372,749,215
  - 2000: $371,411,105

- Taxes: In accordance with Internal Revenue Code provisions based on SCE's "stand alone" taxable income and pursuant to CPUC Decision #84-05-036 (OII 24), SCE computed and paid its taxes on the "separate return method" to EIX totaling $753,808,206 in 1999 and 2000.
  - 1999: $431,155,157
  - 2000: $322,653,049

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- Special Dividends: SCE dividends to EIX in excess of those used to pay common dividends are identified below as special dividends. In 1999 and 2000, these funds stemmed from ongoing transition cost recovery of shareholders' investments in SCE's generation assets. The funds were used to repurchase EIX shares of common stock in the open market. Share repurchase is a cost-effective way to reduce a company's capitalization in response to a shrinking asset base. Special dividends in 1999 and 2000 were:
  - ♦ 1999: $290,533,091
  - ♦ 2000: $ 857,000

- Other Transfers: In addition to those identified in my April 11, 2001, testimony other miscellaneous transfers from SCE to EIX occurred during 1999 and 2000. These transfers include various items including amounts for reimbursement of expenses paid directly by EIX and the payment of employee payroll deductions that were withheld from EIX employees[1/].
  - ♦ 1999: $ 5,867,745
  - ♦ 2000: $11,225,247

5) *For each of the three (3) categories of allowable transfers [dividends of earnings, payment of taxes, and special dividends], please specify how much money SCE transferred to its parent company during the first three months of 2001.*

For the First Quarter of 2001, SCE has ***not*** paid any dividends, taxes or special dividends to EIX.

As previously stated, SCE will provide answers to the Sections entitled "Long Term Contracts," "Bilateral Contracts," "Stranded Costs" and "FERC's Market Mitigation Plan" on June 8, 2001. We appreciate the Committee's patience and interest in this matter. If I can provide any additional information, please contact me at (626) 302-1903.

Sincerely,

Stephen E. Pickett

Stephen E. Pickett
Vice President and General Counsel
Southern California Edison

cc: The Honorable Henry Waxman, Ranking Minority Member
House Committee on Government Reform

1/ Specifically, the transfers here include the payments for payroll deductions; and reimbursements for insurance premiums paid for by EIX; and reimbursements for over funded payroll advances.

SOUTHERN CALIFORNIA
EDISON
An EDISON INTERNATIONAL℠ Company

Stephen E. Pickett
Vice President &
General Counsel

June 8, 2001

The Honorable Dan Burton, Chairman
House Committee on Government Reform
United States House of Representatives
Washington, D.C. 20215

The Honorable Doug Ose, Chairman
Subcommittee on Energy Policy, Natural Resources
and Regulatory Affairs
United States House of Representatives
Washington, D.C. 20215

{Via Facsimile and U.S. Mail}

RE: Committee Questions

Dear Chairmen Burton and Ose:

As a follow-up to my May 25, 2001, letter Southern California Edison (SCE) is pleased to provide the House Committee on Government Reform with the answers to the remaining questions posed on May 16, 2001. We appreciate the Committee's patience on this matter.

The Committee's questions are re-stated below in *italics* with SCE's answers directly below each question.

Long Term Contracts

1) *Please describe in detail the terms and conditions of the long-term contract proposals received by SCE in the summer of 2000.*

Prior to August 3, 2000, SCE had no authority from the California Public Utilities Commission (CPUC) to purchase power outside the California Power Exchange (CalPX). SCE's ability to purchase power in the CalPX markets was limited to the products offered by the CalPX and in other respects by the CPUC. These CPUC restrictions pertained to the duration, type, and quantity of CalPX contracts. For example, SCE never had authority from the CPUC to enter into contracts in the CalPX markets extending beyond March 31, 2002.

This question does not provide a definition of a "long-term contract." In the past, SCE has defined a long-term contract as a contract with a term greater than 5 years. According to this definition, SCE lacked the authority to enter into a long-term contract through the CalPX during the summer of 2000. As a practical matter, however, virtually all of the trading that did take place in CalPX forward markets was in products having delivery within the next 12 months. SCE would not consider such transactions to be "long-term."

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Prior to August 3, 2000, SCE received a few unsolicited contract proposals; however, because SCE lacked the authority to contract for power outside the CalPX prior to August 3, 2000, these proposals were not actionable. Accordingly, and because these offers were submitted with the expectation of confidential treatment, SCE is not including details about these offers in this letter.

On July 21, 2000, SCE filed an emergency motion to the CPUC for approval to enter into bilateral contracts (that is, contracts directly with individual power sellers and outside the CalPX). SCE had previously requested CPUC approval to enter into bilateral contracts in March 1999. The CPUC had denied this request in July 1999.

Acting on SCE's July 21, 2000, emergency motion, on August 3, 2000, the CPUC authorized SCE to purchase power up to certain quantity limits under bilateral contracts. Specifically, the CPUC's authorization allowed SCE to sign "near-term" bilateral contracts up to 2 years in duration (delivery through December 31, 2002) and solicit offers for "medium-term" bilateral contracts up to 5 years in duration (delivery through December 31, 2005). Offers for medium-term bilateral contracts were to be submitted for CPUC acceptance, and if pre-approved, could then be signed.

SCE's near-term bilateral contracts were subject to CPUC reasonableness review if a 5% "safe-harbor" tolerance band on average, annual price was exceeded. For medium-term bilateral contracts, the CPUC's August 3, 2001, order specified that the CPUC would act on SCE's request for contract pre-approval within 30 days. In August 2000, SCE solicited offers for medium-term bilateral contracts (Request For Offers or "RFO"). Responses to this solicitation were received in mid-September 2000. These offers were either "indicative" (non-binding) or expired in a matter of a few hours.

One of the conditions of the RFO is that all individual offers are confidential; however, please note that in the aggregate, SCE received offers for 1,275 megawatts (MW) of capacity contracts and 1,795 MW of firm energy contracts. For the standard 6X16 energy contract (delivery from Monday through Saturday, 6:00 a.m. to 10:00 p.m., excluding holidays), 5-year prices ranged from $57/megawatt-hour (MWh) to $65/MWh. For the 7X24 energy contract, 5-year prices (with the exception of one bid) ranged from $51/MWh to $55/MWh.

SCE submitted all offers received, as well as its analysis and ranking of offers and the procedure for refreshing and awarding expired bids, to the CPUC staff (the Energy Division) for pre-approval. SCE met with the Energy Division to review bids, explain its analysis and ranking, explain the procedure for refreshing and awarding bids, and answer all questions. Nevertheless, the CPUC failed to respond to SCE's request for pre-approval of contracts within 30 days (or to this date). Based on the CPUC's failure to act within 30 days, and allowing for additional discussions with CPUC commissioners and staff, SCE deemed that the submitted contracts were pre-approved. In November 2000, SCE refreshed and awarded bids for firm energy contracts.

Bilateral Contracts

1) *Please describe in detail the terms and conditions of the bilateral contracts into which SCE entered following the CPUC's August 3 order. Please provide to the Committee copies of those contracts.*

SCE entered into 20 separate bilateral transactions with 6 separate counter-parties for the purchase of fixed-price firm energy. These transactions were both near- and medium-term bilateral contracts. Five medium-term (5-year) bilateral contracts for firm energy were entered into in mid-November 2000 and totaled 350 MW. These contracts were both 6X16 (on-peak delivery) and 7X24 (round-the-clock delivery). The remaining bilateral contracts were near-term (less than 2-years in duration). Eleven of the 20 transactions were terminated by the respective counter-party in mid-January 2001 due to cross-default provisions in the contracts and SCE's non-payment of certain indebtedness.

The terms and conditions of all the bilateral contracts are confidential. Due to the fact the contracts contain confidentiality clauses, copies are not enclosed with this letter.

2) *Is your contention that you were prevented from entering into long-term contracts by the CPUC's failure to pre-approve contracts contradicted by the fact that SCE did in fact enter into some contracts following the August 3 order?*

No. As discussed above, SCE submitted contracts to the CPUC for pre-approval in mid-September 2000. The refusal of the CPUC to act on SCE's request delayed SCE's process of refreshing bids and signing contracts until mid-November 2000. In early December 2000, SCE requested that the CPUC promptly pre-approve capacity contracts. The CPUC failed to respond (to this date) to this request as well.

SCE's creditworthiness deteriorated in late December 2000 and early January 2001 to the point that suppliers would no longer contract to sell power to SCE. Accordingly, the CPUC's failure to promptly pre-approve SCE's contracts effectively prevented SCE from entering into contracts beyond those signed in mid-November 2000. Because the CPUC's August 3, 2000, order specified a 30-day process for reviewing contracts and acting on pre-approval requests (SCE had recommended a 10-day process), SCE believes that it was required to wait at least 30 days for the CPUC to complete its review. SCE was not authorized to enter into medium-term (5-year) contracts without submitting the contracts to the CPUC for pre-approval. Observing the CPUC's refusal to implement the pre-approval process, in December 2000 SCE requested CPUC approval to sign medium-term bilateral contracts without pre-approval, but subject to later reasonableness review. The CPUC's Office of Ratepayer Advocates (ORA) protested SCE's request, arguing that pre-approval of contracts was essential. The CPUC has not (to this date) ruled on SCE's request.

3) *What is your interpretation of the CPUC's "reasonableness" standards?*

It is clear from several CPUC decisions dating back to 1995 that the CPUC considered power purchases from the CalPX and the California Independent System Operator (CAISO) markets to be "per se" reasonable (a result of the CPUC's endorsements of these markets). As mentioned above, however, SCE was not authorized to enter into transactions outside the CalPX and CAISO until August 3, 2000. Beginning on that date, SCE was authorized to enter into medium-term (5-year) bilateral contracts that had been "pre-approved" by the CPUC. SCE believed that CPUC pre-approval of the contract meant that the CPUC considered the contract to be "reasonable."

Unfortunately, the CPUC's ORA believed that "pre-approval" only meant that the contract could be signed, not that it was reasonable. In a protest filed with the CPUC on September 1, 2000, ORA argued that pre-approved contracts should be reviewed for reasonableness at a later date. Recognizing that its protest could delay approval of the tariff change that would permit SCE to record the costs of its bilateral contracts for later recovery from retail customers, ORA asked for the CPUC to rule on its protest by September 21, 2000. Nevertheless, the CPUC did not act on ORA's protest until December 21, 2000, although it did rule in SCE's favor. The other category of bilateral contractsauthorized by the CPUC on August 3, 2000, was a near-term (2-year) contract. The CPUC decision provided that such contracts would be reviewed for reasonableness if the average price of these contracts exceeded a 5% safe-harbor band over an annual period; however, the CPUC did not specify the standards it would use to evaluate reasonableness of such contracts if the safe-harbor band was exceeded.

On December 21, 2000, the CPUC issued a decision proposing and seeking comments on procurement reasonableness standards. This decision stated that "[t]he proposal issued today is prompted largely by our concern that these three utilities may be underutilizing the price-moderating potential of bilateral forward purchases because of the risk of after-the-fact review of the purchases." The decision further stated "[w]e act today in response to Governor Gray Davis' request that we 'expeditiously develop benchmarks to assure the reasonableness of these contracts without unfairly 'second guessing' the utilities' purchase decisions in later years." In addition, this decision stated that the CPUC would consider a fixed-price, 5-year, 7X24 contract having a price of 6 cents per kilowatt-hour or less to be reasonable (provided the contract was not with an affiliated company). At the time, the market price for such a contract was nearly 50% higher than the price the CPUC considered to be reasonable. SCE expressed this concern as well as several other concerns in its comments on the proposed reasonableness standards. To date, the CPUC has not issued a decision adopting procurement reasonableness standards for the utilities.

4) *How did the CPUC's failure to provide useful guidelines on "reasonableness" affect your business decisions during this time period?*

The CPUC's failure to adopt practical procurement guidelines and reasonableness standards effectively precluded SCE from entering bilateral forward electricity procurement contracts at a time when prices were much lower than they have been in the recent past. Under the CPUC's rulings, SCE was unable to even solicit offers for bilateral contracts until August 2000. Even then, the offers were subject to a cumbersome and time-consuming approval process at the CPUC.

Some argue that SCE should have gone ahead and entered bilateral contracts without CPUC pre-approval. As described above, the CPUC's rulings prevented that until it was too late. Moreover, SCE makes no money on power procurement for its customers – wholesale power costs are (or are supposed to be) passed through to customers with no mark-up. Subsequent after-the-fact reasonableness reviews by the CPUC can only disallow recovery of costs on which SCE makes no profit whatever. In such an environment, with no clear CPUC guidelines on what constituted "reasonable" electricity procurement and with billions of potentially disallowable dollars at stake, SCE had no practical choice but to seek CPUC pre-approval of any bilateral electricity purchase contracts.

Stranded Costs

1) *Does SCE consider the TURN Proposal a more appropriate standard?*

SCE believes that the TURN Proposal constitutes illegal retroactive ratemaking and the CPUC's adoption of it was a mistake. The TURN Proposal requires SCE to transfer operating costs, now recorded in SCE's Transition Revenue Account (TRA), to SCE's Transition Cost Balancing Account (TCBA.) As explained in detail in SCE's responses to Questions 2 – 4 below, SCE presently has no means of recovering all of the costs now recorded in the TCBA, because some of the AB 1890-era revenue sources for recovering transition costs have been eliminated by recent California legislation and the dysfunctional market.

The TURN Proposal has the effect of: (1) transforming utility operating expenses for customer electricity procurement into unrecoverable competition transition costs; (2) potentially preventing SCE from recovering those costs; (3) violating the federal filed rate doctrine; and (4) violating the statutory mandate to end the rate freeze as expeditiously as possible. Because the CPUC unlawfully applied the TURN Proposal retroactively, it effectively left SCE with no means of recovering more than $3 billion, which is the net "undercollection" (SCE's excess costs for purchased power less the revenues from selling the output of its generation in the market.)[1]

2) *Some have argued that the accounting change is a regulatory taking of assets. What are the views of SCE on this subject?*

Although the TURN Proposal is often described as an "accounting change," it is far more significant. The TURN Proposal was intended to force SCE to write off legitimate power purchase costs after the end of the rate freeze. At present, the CPUC has provided no means of recovering the purchased power costs that SCE transfers to the TCBA. Thus, the TURN Proposal forces SCE to transfer the costs of purchasing power to the TCBA at a time when SCE has been deprived of the ability to recover the costs booked into the TCBA. As explained below, absent a ruling by the federal court, legislation or some action by the CPUC enabling SCE to recover those costs, the TURN Proposal will result in an unlawful confiscation of SCE's property.

Utility takings law is grounded in the principle that the property of a utility, although employed for the convenience of the public, belongs to the utility and cannot be taken from it without due process of law. Investors entrust capital to the utility in good faith, with the expectation that regulators will treat them fairly. "The basic principle of ratemaking is to establish a rate which will permit the utility to recover its costs and expenses *plus* a reasonable return on the value of property devoted to public use."[2] "If the rate does not afford sufficient compensation, the State has taken the use of the utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."[3]

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1 SCE believes that the U.S. District Court federal court will eventually recognize that SCE's power purchases are recoverable pursuant to the federal filed rate doctrine, or, alternatively, that the CPUC or the California Legislature will provide some mechanism for recovery.

2 Southern California Gas Co. v. PUC, 23 Cal. 3d 470, 476 (1979).

3 Duquesne Light Co. v. Barasch, 488 U.S. 299, 308 (1989). It also is contrary to AB 1890, which was designed neither to deprive SCE of recovery of its normal operating expenses nor to change the long-standing principle that a utility is entitled to recover its reasonable operating costs.

By ordering that SCE's TRA undercollection be transferred to the TCBA, the TURN Proposal may have the effect of preventing SCE from achieving the recovery of costs to which it is constitutionally entitled and thus effect a "taking." The reason is that at present there is a pileup of costs into the TCBA, which will not be recovered. California ABX1-6 forced SCE to retain its existing plants, and thus deprives it of the ability to offset transition costs with the proceeds of the sale of plants. ABX1-6 also requires SCE to use its retained generation for the benefit of the public, rather than selling its output into the market. This eliminated another important source of transition cost recovery, market energy revenues. TRA headroom, a third source of transition cost recovery, exists only so long as the California Department of Water Resources (CDWR) covers SCE's net short position. Requiring utilities to retain their remaining generation and sell the output to customers at cost-based rates is not necessarily illegal or a taking, but it assumes the essential *quid pro quo* of allowing the utility to recovery in rates its reasonable costs of providing service, including the cost of procuring electricity for its customers.[4] Unfortunately, the TURN accounting proposal adopted by the CPUC does not do that, but rather creates a situation in which SCE has no realistic way of recovering its costs.

This constitutes confiscation. Both federal courts and the California Supreme Court have made it clear that the regulated entity need not show that it will be driven into financial ruin in order to establish that a rate applicable to it is confiscatory, although in this case, that would hardly be difficult to do.[5] The California Supreme Court has made clear that the standards for a takings claim under the California Constitution are in accord with federal decisions and that a regulatory agency is required to take into account the utility's "interest in maintaining access to capital markets, the ability to pay dividends, and general financial integrity."[6]

Transferring purchased power costs to an account where recovery will likely be impossible violates this constitutional standard. Without federal court or legislative intervention, or a CPUC-designed means of recovering its purchased power costs, SCE will be forced to write off these costs permanently. If that were to happen, it would be a taking of SCE's property without just compensation.

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4 Indeed, under its agreement with Governor Davis, SCE has agreed to retain its remaining generation and sell the output to its customers at cost-based rates for 10 years.

5 See, e.g., Jersey Central Power & Light v. FERC, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (en banc). In that case, the District of Columbia Circuit found that the elements outlined in an earlier case – financial integrity, access to credit, ability to attract capital – were the "minimum requirements" to ensure against a constitutional taking. The court held that these constitutional requirements obligated FERC to consider evidence that the utility was unable to realize its operating and capital costs and that its ability to obtain credit was severely impaired. FERC could not ignore these facts in favor of a test that would require the utility to show that bankruptcy was imminent.

6 Calfarm Ins. Co. v. Deukmejian, 48 Cal. 3d 805, 818, n.9 (1989). See also 20th Century Ins. Co. v. Garamendi, 8 Cal. 4th 216, 296-97 (1994) (holding that a confiscatory rate is one that imposes the type of "deep financial hardship" described in Hope Natural Gas).

3) *How does the TURN Proposal affect the Transitional Recovery Account and the Transition Cost Balancing Account?*

In order to understand the implications of the TURN Proposal, it is necessary to review briefly the AB 1890-era cost recovery system. At the heart of that system were the TCBA and TRA. The TCBA was designed to track transition costs (also known as "stranded costs") and the revenues used to offset those transition costs. It was necessary to create a separate account to track transition (as opposed to operating) costs because the rate freeze would end as soon as transition costs were fully recovered. Thus, only transition costs and the revenues which were allowed to offset them (including headroom, generation revenues, Rate Reduction Bond credits, and the above-book value of generation plants) were recorded in the TCBA. Operating costs, including power purchase costs, were separately recorded in the TRA. They were to be recovered as incurred.

In the past, TRA "headroom" was used as one means of offsetting transition costs. Headroom was calculated by taking the total revenues which SCE received in any given month (which were recorded in the TRA), and subtracting operating expenses (which were also recorded in the TRA.)[7] If headroom existed, that is to say, there was an excess of revenues over operating expenses, the headroom revenues were transferred from the TRA to the TCBA to offset transition costs. If headroom was a "negative,"[8] that is to say, operating expenses exceeded revenues, no transfer was made. Instead, the so-called "negative headroom" would remain in the TRA where it could be offset by revenues in following months.

The CPUC, in designing this process, rejected the concept of a transfer of "negative headroom," from the TRA to the TCBA. The CPUC noted that "none of the components in the TRA, including the CalPX payments, were prescribed as transition costs by law."[9] "Therefore, if negative balances from the TRA, whether generated by the entries related to the CalPX payment or any other components of the TRA, were to be allowed into the TCBA, effectively they would become transition costs eligible for cost recovery, which is inconsistent with the plain language of the statute."[10]

The TURN Proposal, recently adopted by the CPUC, represents a reversal of CPUC policy. Unfortunately, it has the effect that the CPUC warned against in Resolution E-3527 – it causes a pileup of additional costs in the TCBA <u>that are not transition costs, but are treated as if they were transition costs</u>. At this time, however, there is no means for SCE to offset those costs because most of the sources of cost recovery are gone.

Under AB 1890, the utilities were at risk for recovery of their "stranded costs" as defined by the statute. However, they were not at risk for recovery of their electricity procurement costs. This is the only interpretation of AB 1890 that is consistent with the long-standing federal filed rate doctrine. The U.S. Supreme Court has long held that federally tariffed rates must be passed through to customers. The basis for the Court's ruling is grounded in the supremacy clause of the constitution. The theory is that if the states were not required to pass through federally tariffed costs, they would be impermissibly interfering with the federal ratemaking scheme. AB 1890 established the CalPX as a FERC jurisdictional wholesale

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[7] This is a very general description of the headroom calculation.

[8] The "negative" is actually recorded in the TRA as a credit balance.

[9] Resolution E-3527, p. 5.

[10] Resolution E-3527, p. 5.

energy supplier. The CalPX's tariffs are on file with the FERC. Therefore, under well established federal law, the costs of energy purchased out of the CalPX must be passed through to customers. The CPUC's retroactive adoption of the TURN accounting proposal is nothing more than an attempt to dodge the application of the law to it by renaming the costs as "stranded costs" rather than what they really are: federally tariffed electricity procurement costs.

4) *With this new accounting procedure, will SCE be able to collect against its stranded costs as envisioned in AB 1890?*

AB 1890 provided four sources of "revenue" in which to recover the transition costs recorded in the TCBA: (1) "headroom," which was the excess of revenues over operating expenses; (2) revenues from SCE's retained generation plants; (3) Rate Reduction Bond imputed revenue; and (4) the above-book value of SCE's plants (sold or retained.)

The dysfunctional market, along with California ABX1-1 and ABX1-6, eliminate much of the utilities' means of recovering transition costs. ABX1-6 deprives SCE of an important source of revenue: it prohibits SCE from selling its generation plants and requires SCE to use the power from those plants "for the benefit of California ratepayers," thus depriving SCE of market-rate generation revenues or the gain on sale of plants.[11] Headroom did not exist for almost a year. Some headroom exists now only because CDWR is procuring SCE's net short position, but it may not be sufficient to make up for both the lost generation revenues and the past net undercollection.

What this means is that while the TURN Proposal adopted by the CPUC forces SCE to move purchased power costs into the TCBA, new California legislation took away almost all means of recovering costs in the TCBA.

The short answer to the question is that if the CPUC's adoption of the TURN accounting proposal stands, it is extremely unlikely SCE will be able to collect its stranded costs as envisioned in AB 1890.

FERC's Market Mitigation Plan

1) *Do you believe that FERC's market mitigation plan will help keep prices down this summer?*

The Federal Energy Regulatory Commission's (FERC) market mitigation plan is likely to be ineffective in reducing prices this summer. Since it only applies to Stage 1 or greater events, and it allows for marketers to sell to the CAISO with price limitations based only on their contract costs, the potential for evasion of any effective price mitigation is too great for the plan to be effective.

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11 New P.U. Code § 377, enacted by Assembly BillX1-6. Even if ABX1-6 could be construed as permitting the sale of SCE's generation into the CalPX, it gives SCE little comfort, since the CalPX is no longer a functioning entity.

SCE believes the fundamental action to be taken by the FERC should be to deny market-based pricing authority unless/until it can be demonstrated that: 1. the wholesale electricity market is workably competitive; 2. electricity sellers cannot exercise market power; and 3. wholesale electricity prices resulting from the operation of the market are just and reasonable.

2) *Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?*

FERC's market mitigation plan has the potential to increase the number and magnitude of blackouts this summer. If California generators commit their output to marketers, they can evade the requirement to make power available in real time to the CAISO. If marketers can command a higher selling price to the CAISO by withholding some output, then there will be an incentive to do so. If the monitoring of such activity doesn't provide quick and effective penalties for such behavior, the potential for abuse could be great. California's recent experiences with all of these activities leads us to believe that blackouts are more likely under this plan than other recommended forms of market power mitigation, such as cost based bid limitations.

3) *Will FERC's market mitigation plan discourage out-of-state generators from selling their power into California?*

There do not appear to be any elements of the FERC plan that should discourage out-of-state generators from selling power to California.

4) *Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?*

Market power mitigation should be applied equally to all regions within a common market. Mitigation measures limited to a single state have the potential of encouraging exports from that state if the sellers can be successful at extracting greater market power rents from neighboring states, which are not subject to the same degree of price mitigation. FERC's market mitigation plan may not be an effective deterrent to the exercise of market power, thus its imposition, without improvement, to the entire WSCC may not produce the desired results.

5) *Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?*

To the extent that municipalities and power marketing administrations (PMAs) must abide by the CAISO tariffs in order to participate in the CAISO markets and make use of the CAISO operated grid, they should be required to abide by the market mitigation plan. The mitigation plan requires unscheduled power to be made available to the CAISO.

6) *Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?*

Brokers can effectively avoid the confines of FERC's market mitigation plan by reselling the power they purchase through bilateral transactions prior to sale to the CAISO. The limitations on the price of power ultimately sold to the CAISO in real time are thus virtually nonexistent. It is not an unusual practice for power to trade hands multiple times prior to delivery. That practice is now effectively rewarded with impunity from any price mitigation. This loophole is likely to completely eviscerate the mitigation plan.

7) *Will the plan protect consumers from megawatt laundering?*

Consumers will be entirely vulnerable to megawatt laundering. The practice of selling power out of the state to turn around and sell it back to the CAISO in real time when the CAISO is more desperate was a documented practice in the year 2000. With the potential to evade any and all price mitigation through this same practice in 2001, the incentive for its use is increased substantially. Consumers are entitled to protection from such schemes designed explicitly to manipulate prices. Thus far, no FERC action has provided consumers such protection, and the current FERC price mitigation plan provides a strong incentive to sellers to utilize such megawatt laundering schemes to gouge California's consumers.

SCE appreciates the Committee's earlier consideration in providing SCE with additional time in which to provide these answers.

Very truly yours,

Stephen E. Pickett

Stephen E. Pickett

cc: The Honorable Henry Waxman, Ranking Minority Member
House Committee on Government Reform

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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May 23, 2001

Mr. Steve Malcolm
President
Williams Energy Services
1 Williams Center
Tulsa, Ok 74172

Dear Mr. Malcolm:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 12 in San Diego. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Profits in California

During the April 12 hearing, your were asked a number of questions about Williams' profits, both nationally and in California. You did not have that information available at the hearing, but offered to provide it.

Please respond to the following questions:

1. What was Williams Energy Service's total revenue and total profit in 1999 and 2000? How much revenue and profit did Williams earn each year in the California market?

2. Did Williams' California profits increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

3. What percentage of your total natural gas load requirement do you obtain on the spot market?

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Plant Outages

During the April 12 hearing, you were asked a number of questions about FERC's show cause order and the Williams AES Southland plant outages at the Alamitos and Huntington Beach plants. For example you were asked if $63 is a good estimate of your fixed costs. However you didn't have that information available at the hearing.

Please respond to the following questions:

1. Is $63 a good estimate of your fixed costs at the Alamitos and Huntington Beach plants during the outage last year?

2. If not, please provide the Committee with a good faith estimate of your fixed costs for the two plants during the outage.

4. Since the April 12 hearing, Williams settled with FERC by agreeing to pay the ISO $8 million without an admission of guilt. During the hearing you stated, "the show cause order was very one-sided and very biased." Given your statements at the hearing, why did Williams choose to settle the case?

5. What is Williams' position on FERC's order requiring Williams to offer the ISO non-RMR units at the RMR rate if an RMR unit at either Alamitos or Huntington Beach is on a forced outage?

The April 30 consent agreement issued by FERC stated the following:

"In materials that Williams voluntarily provided to the Commission staff in the investigation, Williams disclosed that a non-managerial operations employee of Williams indicated to AES Southland that Williams did not object to the extension of the Alamitos 4 outage and the employee's belief that Williams could provide a financial incentive for AES Southland to extend the outage."

1. Does Williams agree with the characterization in Paragraph G of the agreement?

2. What financial incentive did the employee offer to AES to extend this outage?

3. Did this act prolong the Alamitos 4 outage?

4. What measures has Williams taken to ensure this does not happen in the future?

Mr. Steve Malcolm
May 23, 2001
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5. Please provide to the Committee all materials cited in Paragraph G of the consent agreement that Williams provided FERC, including documents, audio or video tapes, handwritten notes, and other material.

The April 30 consent agreement issued by FERC also stated:

"The second notice cited a need to dredge the plant's circulation tunnels. Mussel shells and silt had accumulated in the tunnels, causing operational problems. Edison had, when it owned the facility, successfully addressed the problem posed by mussel larvae by scheduling and performing "heat treats," heating the water in the circulation tunnels, and thereby killing the larvae. This practice was discontinued in mid-summer 1998 after AES acquired ownership of the plant, but while the Edison-AES Huntington Beach L.L.C. Operation and Maintenance Agreement still governed operation of the plant."

1. Why did AES discontinue performing "heat treats" at the Huntington Beach 2 unit in 1998 as referred to in Paragraph J of the agreement?

2. Has AES resumed using "heat treats" on the circulation tunnels?

3. In your testimony, you stated that you would provide materials showing this was a necessary outage. Please provide to the Committee this documentation.

Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers in California. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?

2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

3. Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?

4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

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5. Recently Williams declared its support for price caps in the Western region. Why has Williams changed its position on this issue? How long do you think the price caps should last? Would the imposition of price caps increase the risk of blackouts in California? Would the imposition of price caps increase or reduce the incentive to build new power plants in the Western region?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

3. Will the plan protect consumers from megawatt laundering?

Please provide this information to the Committee no later than May 29, 2001. If you have any questions please have your staff contact Caroline Katzin at (202) 225-5074. Your assistance is appreciated.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

cc: The Honorable Henry Waxman
Ranking Minority Member

Williams

One Williams Center
P.O. Box 2400
Tulsa, Oklahoma 74102
918/573-2000

June 6, 2001

The Honorable Dan Burton
Chairman
Committee on Government Reform

The Honorable Doug Ose
Chairman
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs
United States House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515

RE: April 12, 2001 Hearing of the Committee on Government Reform on the California Electricity Crisis

Dear Chairman Burton and Chairman Ose:

With respect to your letter dated May 23, 2001, submitting a series of follow-up questions regarding issues raised at the April 12, 2001 hearing on the California Electricity Crisis, I am pleased to provide you with the following responses.

Profits in California

1) Question: What was Williams Energy Services' total revenue and total profit in 1999 and 2000? How much revenue and profit did Williams earn each year in the California market?

Response: Per Note 23 to The Williams Companies, Inc.'s, 2000 Consolidated Financial Statements, the reported Segment Profit for Williams Energy Services for year 1999 is $529,100,000, and for year 2000 is $1,558,700,000. The reported revenues for Williams Energy Services for year 1999 is $4,900,700,000, and for year 2000 is $8,055,500,000. With respect to your question regarding how much revenue and profit Williams earned in the California market, Williams does not report earnings segregated by geographic region, and, accordingly, we do not possess such information. While a calculation could be done to determine these numbers, such a calculation would be burdensome, difficult to make

Chairmen Burton and Ose
June 6, 2001
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with precision, and disclosure of such financial information in this forum could violate SEC regulations preventing selective disclosure. It is important to note, however, that Williams sells most of its power in California under long-term contracts, at prices well below prevailing spot-market prices.

2) Question: Did Williams' California profits increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

Response: As noted in the response to your first question, Williams does not segregate earnings by geographic region. The majority of the power relating to Williams' reported profits relates to contracts for forward sales, not sales in the real-time markets to which price caps would apply. Nonetheless, Williams actively opposed the reductions to the price caps that occurred during the summer of 2000. It is Williams' general impression that reducing the price caps during the summer of 2000 did not reduce the overall cost of power in the market, and this is supported by the California Independent System Operator ("ISO"). In a report dated September 6, 2000, and released by the ISO's Market Surveillance Committee ("MSC"), entitled "An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Markets," the MSC found that "monthly average energy prices during June 2000, when the price cap was $750/MWh, were lower than monthly average energy prices during August 2000, when the price cap was $250/MWh. This result occurred despite the fact that virtually the same amount of energy was consumed in California during these two months."[1] Id. at 2-3.

3) Question: What percentage of your total natural gas load requirement do you obtain on the spot market?

Response: The amount of gas that Williams obtains on the spot market varies from day-to-day. Williams' general practice is to purchase gas forward for long-term deals and buy spot gas day ahead for short-term transactions. In addition, Williams sells the majority of its available power through long-term deals. At this point in time, well over three-quarters of the power available to Williams is sold under long-term contracts.

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[1] As Chairman Hébert noted in his concurring opinion to FERC's November 1 Order proposing remedies for the California wholesale electric markets, "the Commission's own Staff Report suggests that there is a direct correlation between lower price caps and higher consumer prices. Specifically, it finds that decreases in the ISO price cap this past summer were matched by increases in exports of electricity out of California during the same period. The resulting decrease in net imports, historically relied upon by California, is one of the principle reasons for the increase in wholesale electricity prices." San Diego Gas & Electric Co., et al., 93 FERC ¶ 61,121, 61,384-61,385 (2000) (Hébert concurring).

Plant Outages

1) Question: Is $63 a good estimate of your fixed costs at the Alamitos and Huntington Beach plants during the outage last year?

Response: No.

2) Question: If not, please provide the Committee with a good faith estimate of your fixed costs for the two plants during the outage.

Response: Annual payments to AES per Williams' Tolling Agreement with AES for Alamitos 4 and Huntington Beach 2, and fixed costs per MWh, are as follows:

Alamitos 4:	$9,688,000 ($9.41/MWh)
Huntington Beach 2:	$7,480,000 ($12.05/MWh)

However, these amounts only include annual payments to AES and do not include corporate overhead or other fixed costs and do not include variable costs such as fuel, NOx and variable operating and maintenance expenses.

3) Question: Since the April 12 hearing, Williams settled with FERC by agreeing to pay the ISO $8 million without an admission of guilt. During the hearing you stated, "the show cause order was very one-sided and very biased." Given your statements at the hearing, why did Williams choose to settle the case?

Response: Williams did not agree to pay the ISO $8 million; rather, Williams agreed to refund $8 million to the ISO by crediting outstanding invoices due from the ISO. Additionally, on May 1, 2001, Williams issued the following statement to the press, and it accurately conveys the reasons for which Williams chose to settle: "FERC has terminated the show-cause proceeding without any finding of wrongdoing by Williams. We are confident that a full hearing of the facts would have exonerated us entirely, but were willing to settle this matter in order to turn our full attention to helping shape solutions to energy issues facing California and the nation. Settling the matter provided the best opportunity for Williams to move forward on more productive matters, instead of engaging in a lengthy and costly hearing process."

4) Question: What is Williams' position on FERC's order requiring Williams to offer the ISO non-RMR units at the RMR rate if an RMR unit at either Alamitos or Huntington Beach is on a forced outage?

Response: In Section III(B) of the Stipulation and Consent Agreement entered into between Williams, AES and FERC's Market Oversight and Enforcement

Section, Williams voluntarily agreed to the following provision: "For one year after the Commission approves this Agreement, Williams agrees to accept the following condition on its market-based rate authority. If an RMR unit at the Alamitos or Huntington Beach plants that the ISO would have dispatched to provide voltage support or other reliability service, consistent with applicable RMR agreements, is unavailable due to a forced outage, the ISO may call a non-RMR unit, at either the Alamitos or Huntington Beach plants, to provide that service for the same compensation, including applicable availability amounts, and under the same terms had the RMR units been available; provided that Williams' obligation under this paragraph will in no event extend to more than a total of two non-RMR units at any one time." FERC approved the Stipulation and Consent Agreement, and thus the above provision, in its April 30, 2001 Order concluding the Show Cause proceedings. See AES Southland, Inc., et al., 95 FERC ¶ 61,167 (2001).

5) Question: The April 30 consent agreement issued by FERC stated the following:

"In materials that Williams voluntarily provided to the Commission staff in the investigation, Williams disclosed that a non-managerial operations employee of Williams indicated to AES Southland that Williams did not object to the extension of the Alamitos 4 outage and the employee's belief that Williams could provide a financial incentive for AES Southland to extend the outage."

(a) Does Williams agree with the characterization in Paragraph G of the agreement.

Response: Williams is a signatory to the Stipulation and Consent Agreement, and, as such, may be limited in how it might characterize the above-quoted paragraph. However, it is important to recognize that the above-quoted language from Section II(G) is incomplete. Section II(G) goes on to provide that, "However, Williams did not ultimately pay to AES Southland any financial inducement to extend the outage and AES Southland maintained control of the outage schedule." This last sentence is an integral part of Section II(G). See AES Southland, Inc., et al., Stipulation and Consent Agreement at 10.

(b) What financial incentive did the employee offer to AES to extend the outage?

Response: Williams is a signatory to the Stipulation and Consent Agreement, and, as such, may be limited in how it might characterize the above-quoted paragraph. As Williams agreed in Section II(G) of the Stipulation and Consent Agreement, "Specifically, the employee indicated that the proposed extension of the outage would not count against the availability of the unit." Id. This "indication" was not an offer made on behalf of Williams. Further, the Williams employee involved in this matter would not be in a position to authorize anything that would generate a financial incentive for either Williams or AES. Finally, as noted in the above Response, Williams did not, in fact, provide AES with any financial inducement to extend the outage.

(c) Did this act prolong the Alamitos 4 outage?

Response: To the best of our knowledge, it had no impact on the outage. The occurrence and duration of the outage was at all times in the control of AES. The original Alamitos 4 outage request was for a five day period from April 25, 2000 at 0001 hours to April 30, 2000 at 0001 hours. The request was for a maintenance outage to repair a boiler tube leak. On April 28, AES requested an extension of the outage for an additional six days to May 5. The request was to perform repairs to the heater drip line and also to repair damaged burners.

(d) What measures has Williams taken to ensure this does not happen in the future?

Response: Williams has provided additional training to all employees regarding Williams' duties and obligations under our Tolling Agreement with AES to prevent even the appearance of impropriety in dealings between Williams and AES. Additionally, attorneys in Williams' legal department offer training in anti-trust issues to Williams' employees on a continuing basis.

Price Controls

1) Question: Recently Williams declared its support for price caps in the Western region. Why has Williams changed its position on this issue? How long do you think the price caps should last? Would the imposition of price caps increase the risk of blackouts in California? Would the imposition of price caps increase or reduce the incentive to build new power plants in the Western region?

Response: Williams has not supported regional price caps but, instead, has declared its support for regional price controls. Under a price cap, prices cannot exceed an absolute, arbitrary dollar amount.[2] However, under price controls, a formula is developed that takes into account actual costs and the ability to achieve a reasonable profit. Williams is still opposed to price caps, and our willingness to explore price controls is not inconsistent with

[2] As discussed above, however, during Summer 2000, as California lowered its purchase price caps, the average price of electricity actually increased.

our position on price caps. For your reference, attached as "Attachment A" is a press release issued by Williams on April 25, 2001, discussing Williams' position on price controls.

Price controls should be of limited duration, and should be in effect no longer than through Summer 2002.

Price caps would increase blackouts in California, as caps would discourage investment in the State and encourage exporting of supply in search of uncapped markets. Of equally important concern, to the extent that price caps are not designed to allow for recovery of costs – perhaps even variable costs, including the fluctuating price of natural gas – the danger persists that independent power producers will not be capable of sustaining production. This is not a theoretical problem – several thousand megawatts of power have been unavailable over the past several months as independent power suppliers have faced their own cashflow problems in this market. Reasonable price controls, however, would not increase the risk of blackouts in California, especially if the controls are of a regional nature and if it is absolutely clear that this is an interim measure with a very definite termination date. For this reason, Williams supports regional price controls, rather than controls limited to California.

A reasonable price control of limited duration would not have a materially negative affect on the incentive to build new power plants in the West, but a price cap certainly would. Additionally, the majority of new projects will not be in service until after the current expiration of price controls. Further, it is critically important to note that this concept is considered as part of a comprehensive solution, which would include measures to guarantee payment for past and future sales.

Market Monitoring and Mitigation Order

1) Question: Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

Response: Williams understands that there is an argument that FERC exceeded its authority in imposing certain requirements on municipalities and PMAs. Williams does not know whether they will abide with FERC's market monitoring and mitigation plan, but Williams is hopeful that all market participants, even non-jurisdictional entities, will endeavor to fully cooperate in bringing about a final resolution to the current crisis.

2) Question: Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

Response: It is worth noting that Williams has executed long-term contracts with various parties, including those who might be characterized as energy brokers, since it has been active in the California market. We have been successful in our efforts to sell the majority of the power available to us under long-term contracts. We continue to consider it most unfortunate that the State of California precluded its regulated utilities from negotiating such contracts, which could have allowed for significant mitigation of the price Californians have paid for power over the past several months. Williams has no control over the pricing decisions of the so-called energy brokers when they resell power they have purchased from us. However, Williams believes that FERC's market monitoring and mitigation order properly addresses energy brokers. In its mitigation plan, FERC directed that "during mitigation, marketers can accept the market clearing proxy price or submit their own bid. If their bid exceeds the market clearing price, they would be required to justify the bid based on the prices they paid for power." San Diego Gas & Electric Co., et al., 95 FERC ¶ 61,115 (2001), at 16-17. (emphasis added). Hence, the activity of energy brokers will continue to be subject to close FERC scrutiny.

3) Question: Will the plan protect consumers from megawatt laundering?

Response: Williams is not aware of any megawatt laundering actually taking place. However, to the extent that any market participant will attempt to engage in such activity, FERC has specifically addressed the issue. In its mitigation plan, FERC noted that, "Several commenters are concerned about generators avoiding the must-offer requirement. They raise concerns about so-called 'megawatt laundering' where a supplier schedules supply out-of-state and then reimports that power to avoid a mitigated price. They also contend that imports must be included in the proposal to cap prices for all sales into the ISO market, not just sales made by PGA generators. The Commission recognizes that the California market is integrated with those of other states, and for that reason, is instituting an investigation into public utility sales for resale in the WSCC. In addition, as discussed above, to ensure that the mitigation and monitoring proposal is applied equally to all generators in California, the must-offer obligation will be applied to include non-public utility generators in California which currently make use of the ISO's interstate transmission grid." Id. at 11. Thus, Williams is confident that FERC will actively monitor the market and take prompt action should it discover any improper activity.

If you have should have any questions, please contact me at (918) 573-4401, Alex Goldberg, Senior Regulatory Counsel, at (918) 573-3901, or Glen Jackson, who has responsibility for coordinating our federal legislative efforts, at (202) 833-8994.

Respectfully submitted,

Steve Malcolm/mm

Steve Malcolm
President
Williams Energy Services

cc: The Honorable Henry Waxman
Ranking Minority Member

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04/25/01

Williams Supports Short-Term Regional Price Controls to Help Address California Power Crisis

TULSA -- The chairman of Williams (NYSE:WMB) said today the company supports short-term regional price controls as one measure to help California and other western states address the effects of high electricity prices that are being driven by an inability to produce enough power to meet demand.

"Williams understands that any form of long-term price control is counter-productive to creating adequate energy supply and efficient pricing. This has been true in any market at any time in our history," said Keith E. Bailey, chairman, president and chief executive officer. "But, we also recognize this is an extraordinary situation. We need to help create some breathing room over the next year or so to allow the current emergency supply initiatives to have a meaningful impact. We all have to work together, and this is the right thing to do.

"We also believe a rational course of action that seeks new sources of supply must be combined with public policy that ensures confidence that services provided in the past and future will be paid in full. It is also imperative to design controls in a manner that allows full recovery of costs and a return that is commensurate with risk," he said. "The combination of short-term, regional price controls during emergency periods that eventually expire at a fixed point in time, along with the elimination of credit risk, should provide the market a respite while creating incentive for the private sector to invest with confidence. All these elements are essential."

Williams markets some 4,000 megawatts of power in California, the majority of which was sold in long-term, forward contracts both this year and last.

Bailey said Williams has net accounts receivable at March 31 for power sales to the California Independent System Operator and the California Power Exchange of about $252 million, a net increase of approximately $140 million from year-end 2000. "This is consistent with our ongoing commitment to continue to serve California markets while we work toward finding equitable solutions to the energy crisis," Bailey said. He said Williams started power sales to the Department of Water Resources on April 1 under a long-term agreement signed earlier this year.

About Williams

Williams, through its subsidiaries, connects businesses to energy. The company delivers innovative, reliable products and services. Williams information is available at http://www.williams.com.

Portions of this document may constitute "forward-looking statements" as defined by federal law. Although the company believes any such statements are based on reasonable assumptions, there is no assurance that actual outcomes will not be materially different. Any such statements are made in reliance on the "safe harbor" protections provided under the Private Securities Reform Act of 1995. Additional information about issues that could lead to material changes in performance is contained in the company's annual reports filed with the Securities and Exchange Commission

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Contact Information:

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ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

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www.house.gov/reform

May 23, 2001

Mr. John Stout
Senior Vice President for Asset Commercialization
Reliant Energy
1111 Louisiana Street
Houston, TX 77002

Dear Mr. Stout:

We are writing with regard to the Committee's field hearings last month on the California electricity crisis. Once again, thank you for your testimony on April 12 in San Diego. As indicated at that time, we are writing to submit a series of written questions following up on issues raised at the hearing. These questions, your written responses, and related materials will be included in the hearing record.

Profits in California

During the April 12 hearing, you were asked a number of questions about Reliant's profits nationally and in California. You did not have that information available at the hearing, but offered to provide it.

Please respond to the following questions:

1. What was Reliant Energy's total revenue and total profit in 1999 and 2000? How much revenue and profit did Reliant earn each year in the California market?

2. Did Reliant's California profit increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

3. What percentage of your total natural gas load requirement do you obtain on the spot market?

Mr. John Stout
May 23, 2001
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Market Mitigation Plan

On April 26, 2001, FERC issued an order that includes a market mitigation plan designed to hold down high prices for power this summer. The plan establishes a daily price cap based on the costs of the most inefficient power producers in California. Please provide the Committee with answers to the following questions:

1. Do you believe that FERC's market mitigation plan will help keep prices down this summer?
2. Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?
3. Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?
4. Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Many people are concerned that FERC's market mitigation plan will not apply to entities outside its jurisdiction, such as municipalities, Power Marketing Administrations (PMAs) like the Bonneville Power Administration and the Western Area Power Administration, or power brokers.

1. Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?
2. Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?
3. Will the plan protect consumers from megawatt laundering?

Other Questions

1. The Governor and numerous state lawmakers have made repeated threats to seize power plants through the use of eminent domain. How does this affect your company's decisions to invest in California?
2. Have the State's new plant siting policies encouraged your company to build new plants in California, and has the siting process been expedited as claimed?

Mr. John Stout
May 23, 2001
Page 3

4. The Ninth Circuit recently lifted a lower court injunction forcing Reliant Energy to sell electricity to the California Independent System Operator (ISO) without assurances of payment. How does this affect Reliant's position on sales of electricity to California?

5. Why has your company decided to sell a majority of its power generated in California to entities outside of the state when California is facing a supply shortfall?

6. In preliminary orders issued earlier this year, FERC determined that Reliant overcharged California entities by $20 million in January and February, and required Reliant to refund that amount. Do you agree or disagree with FERC's determination? Please explain why.

7. Why did Reliant file a complaint with FERC last month charging the Cal-ISO with interfering in properly scheduled maintenance outages?

Please provide this information to the Committee no later than May 29, 2001. If you have any questions, please have your staff contact Caroline Katzin at (202) 225-5074. Your assistance is appreciated.

Sincerely,

Dan Burton
Chairman
Committee on
Government Reform

Doug Ose
Chairman
Subcommittee on Energy Policy,
Natural Resources and
Regulatory Affairs

cc: The Honorable Henry Waxman
Ranking Minority Member

Reliant Energy™

FACSIMILE COVER SHEET

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FROM: Bud Albright

PLEASE DISTRIBUTE TO THE FOLLOWING PEOPLE IN YOUR AREA:

The Honorable Dan Burton
The Honorable Doug Ose

If there are problems receiving this **FAX**, please call Susan or Denice at (202)783-7220 Thank you.

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May 29, 2001

The Honorable Dan Burton
Chairman, Committee on Government Reform
The Honorable Doug Ose
Chairman, Subcommittee on Energy Policy,
Natural Resources and Regulatory Affairs
United States House of Representatives
Committee on Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman Burton and Ose:

In response to your request for additional information dated May 23, 2001 addressed to Mr. John Stout, attached are copies of the responses that have been prepared to your questions.

There are several questions that call for the production of confidential information. As Mr. Stout indicated at the time of the hearing, appropriate confidentiality protections need to be put into place to protect this commercially sensitive information from disclosure. I have attempted to contact Committee staff to discuss this issue in order to determine whether there is information that could be provided to you to address your concerns on a nonconfidential basis. With regard to the balance of the materials, I trust that if you have any questions concerning any of the responses attached, that you will contact us.

We appreciate the opportunity to participate in the Committee's hearings and look forward to continuing to work with the Committee on these important matters.

Sincerely,

Bud Albright

Bud Albright

Attachment

__Question 1 -__
What was Reliant Energy's total revenue and total profit in 1999 and 2000? How much revenue and profit did Reliant earn each year in the California market?

Answer...We have interpreted the reference to "profit" in your question to mean "net income". Reliant Energy's total revenue and net income for 1999 and 2000, as publicly reported is shown in the following table (all values in $ million):

	1999	2000
Revenues	$15,223	$29,339
Net Income	$1,482	$447

With respect to the second half of the question, the requested information will be provided upon the satisfactory resolution of concerns over the confidentiality of such information.

__Question 2__
Did Reliant's California profit increase as the California price caps were lowered last summer? Please provide the Committee with a month by month breakdown of profits from May 2000 to April 2001.

Answer... From our analysis, it does not appear that monthly operating income increased after the price caps were lowered in August of last year.

With respect to the second half of the question, the requested information will be provided upon the satisfactory resolution of concerns over the confidentiality of such information

__Question 3__
What percentage of your total natural gas load requirement do you obtain on the spot market?

Answer...We obtain natural gas in the spot market in balance with the amount of electricity we sell into the spot market. During the first quarter of 2001, that percentage was approximately 65%.

MARKET MITIGATION PLAN

__Question 1__
Do you believe that FERC's market mitigation plan will help keep prices down this summer?

Answer...Yes, FERC's market mitigation plan implements a variable cost cap during Stage 1, 2, and 3 emergencies that is likely to reduce market prices, both spot and term, for this summer by inappropriately excluding several basic cost components. In fact, based on current gas prices, the FERC order would limit clearing prices based on our facilities to less than $230/mwh, a level lower than any of the hard caps used by the ISO in past years. We further expect the ISO to be in Stage 1 or higher most of the hours during the summer season, resulting in a corresponding application of the FERC mitigation plan for most hours.

__Question 2__
Do you believe that FERC's market mitigation plan will lead to more or fewer blackouts this summer?

Answer...We believe that some elements of the FERC mitigation plan will increase the probability of blackouts this summer. Specifically, the lower wholesale prices, as explained above, and failure to recognize real business costs, such as opportunity costs, as justifiable, will likely increase peak demand and reduce supply imports from energy constrained resources, particularly Canadian hydro.

<u>Question 3</u>
Do you believe that FERC's market mitigation plan will discourage out-of-state generators from selling their power into California?

Answer…As indicated in our response to question 2, we believe that the FERC mitigation plan will reduce imports into California. In particular, failure to recognize costs such as opportunity costs as legitimate bid justification will force hydro resources to be retained for local use. If a limited hydro resource is sold into California during a capacity shortage, the owner risks purchasing replacement energy at a later time. The cost of that replacement energy is a rational business basis for bidding above production cost and should not be prohibited under the FERC mitigation plan.

<u>Question 4</u>
Should FERC's market mitigation plan be limited to California or should it be extended to the entire Western System Coordinating Council?

Answer…Extending the FERC California market mitigation plan to the entire WSCC may not be practical since the rest of the WSCC lacks a visible spot market based on a single clearing price. Without such, it is difficult to understand how the mitigation plan used in California could function since it depends on a single market clearing price.

PMA's

<u>Question 1</u>
Do you believe that municipalities and PMAs will have to abide by the market mitigation plan?

Answer…Our interpretation of the proposed FERC order is that the California market mitigation plan is applicable to PMA's and municipalities due to the fact that they utilize the ISO's interstate transmission grid. The relevant language is found on pg. 10-11 of the order.

<u>Question 2</u>
Critics also claim that energy brokers will be allowed to avoid the confines of FERC's market mitigation plan. What is your opinion on this matter?

Answer…We do not believe that energy brokers are exempted from the mitigation plan proposed by the FERC order. Page 17 clearly states marketers must accept the proxy price or they must justify their bids based on the price they actually paid for the power.

<u>Question 3</u>
Will the plan protect consumers from megawatt laundering?

Answer…We must first clarify what we believe you are referring to as "megawatt laundering". Some parties have alleged that suppliers "launder" megawatts by selling forward contracts to other parties who in turn may sell that energy back to California through the ISO spot markets. We do not feel that such is "laundering" because the original supplier does not benefit financially from the spot market sale, all they receive is the original sale price. Such transactions are straightforward examples of forward hedging to avoid risk in the spot market. With respect to your question, our understanding of what is meant by the term megawatt laundering requires the original supplier to receive additional compensation that is directly related to the compensation received from the subsequent resale into the CAISO market. That said, the proposed FERC order has clear protections against this type of abuse. Any power being sold back into the ISO market from a party outside the ISO during tight supply situations must be sold at the mitigated market clearing price, or the seller must justify the cost basis of the transaction. If the seller chooses the latter approach, FERC has the authority to audit the supporting documentation, and should therefore be able to detect the type of contractual arrangements that we believe would be considered laundering.

OTHER QUESTIONS

<u>Question 1</u>
The Governor and numerous state lawmakers have made repeated threats to seize power plants through the use of eminent domain. How does this affect your company's decisions to invest in California?

Answer...The political and regulatory environment in California is a major factor that necessarily impacts Reliant's business decisions on whether to make new investments in the State. Given the substantial need for new energy infrastructure across the U.S., California's instability diminishes its value as an investment option relative to other regions of the country.

<u>Question 2</u>
Have the State's new plant siting policies encourage your company to build new plants in California, and has the siting process been expedited as claimed?

Answer...California has made progress in expediting the power plant siting process. However, this progress has been offset by increasing political and regulatory instability. The risks posed by this instability would be a major factor in any decision by Reliant to build a new power plant in California.

<u>Question 3</u> - **No question listed with this number**

<u>Question 4</u>
The Ninth Circuit recently lifted a lower court injunction forcing Reliant Energy to sell electricity to the California Independent System Operator (ISO) without assurances of payment. How does this affect Reliant's position on sales of electricity to California?

Answer...If the CAISO complied with the provisions of its FERC-approved tariff and the requirements of a recent FERC Order requiring the CAISO to adhere to the creditworthiness standards in its tariff, the Ninth Circuit's action would have no impact on our sales to California. Unfortunately, recent public pronouncements by the CAISO (Statement of Terry Winter before House Committee on Government Reform, Sacramento, Ca, Field Hearing, April 10, 2001 and the CAISO compliance filing on creditworthiness requirements, submitted to FERC on May 11, 2001) indicate that CAISO does not intend to fully comply with the creditworthiness requirements in its tariff. The lack of tariff compliance has a destabilizing impact on the market and increases the risk of blackouts.

Still have a % of power on the table

<u>Question 5</u>
Why has your company decided to sell a majority of its power generated in California to entities outside of the state when California is facing a supply shortfall?

Answer...This question is factually inaccurate. Our company has not sold the majority of its energy to entities outside the state of California. During 2000 the energy sold outside of California represented about 6% of the total energy we produced.

<u>Question 6</u>
In preliminary orders issued earlier this year, FERC determined that Reliant overcharged California entities by $20 million in January and February, and required Reliant to refund that amount. Do you agree or disagree with FERC's determination? Please explain why.

Answer...We disagree with FERC's calculation of the amount and with the characterization of the $20 million as an overcharge. We believe that the FERC order simply used a generic screening tool to identify transactions for which detailed cost justification in required. We have submitted the requested cost justification, but FERC has not yet ruled on the adequacy of our justification package. We believe that the inclusion of daily versus monthly fuel cost differences, opportunity costs, and risk premiums fully justify the bids in question.

<u>Question 7</u>
Why did Reliant file a complaint with FERC last month charging the Cal-ISO with interfering in properly scheduled maintenance outages?

Answer... As detailed in the complaint, Reliant had a previously scheduled maintenance outage planned for Etiwanda Unit 3. This outage was to perform maintenance necessary to ready the unit for summer operation as well as to install emission control equipment necessary to substantially reduce NOx emissions. Despite the fact that the maintenance outage had been scheduled and approved in advance with the ISO, as the actual date of the outage approached, the ISO began to give indications that it did not intend to allow Reliant to proceed with the outage.

Because this unit had been operated at extremely high levels during the months preceding the scheduled outage, there were a number of operating problems with the unit that threatened to cause a potentially catastrophic failure of the unit. These included an economizer tube leak that was getting progressively worse. Reliant informed the ISO of these conditions and of Reliant's concern that continued operation of the unit was going to ultimately result in a forced outage. Reliant also informed the ISO that delaying this outage would have several negative implications. Attached is a chart depicting the differences between the proposed ISO maintenance schedule and the originally approved ISO maintenance schedule. Additionally, work crews had already been arranged to conduct the outage since the outage was being done in parallel with a similar outage that was already underway on Etiwanda Unit 4.

The compliant proceeding was filed to seek a determination regarding whether, under these circumstances, the ISO was entitled to reschedule this maintenance outage without regard for the cost, reliability and other implications associated with such actions. The attempted actions taken by the ISO seemed to be motivated more by short term considerations rather than considerations regarding the long term stability of the system over the upcoming summer.

The maintenance outage on Etiwanda Unit 3 is proceeding and the unit is expected to be back online prior to the peak summer season.

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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WASHINGTON, DC 20515–6143

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May 22, 2001

Chairman Curt Hebert
Commissioner Linda Key Breathitt
Commissioner William Massey
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Dear Mr. Chairman and Other Commissioners:

As Chairman of the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, with jurisdiction over the Federal Energy Regulatory Commission (FERC), I am writing to inform you of my intent to introduce legislation. This legislation will help prevent unjust and unreasonable electricity rates in California specifically and in the other Western States at large.

The energy crisis facing California is the single greatest threat to the economic well-being of California in decades. According to the North American Electric Reliability Council, California will be 4,500 to 5,500 megawatts (MW) short of power during peak demand periods this summer, resulting in up to 15 hours of blackouts per week. Industry experts predicted summer blackouts will cost California $21.8 billion in lost output and eliminate 135,000 jobs. The human suffering will be equally severe. Blackouts will cause real hardship and even death when temperatures reach their peak this summer.

While I appreciate FERC's efforts to find solutions to the energy crisis in California, this unprecedented crisis demands bold action. FERC's April 26, 2001, market mitigation plan for California was a good first step towards reducing skyrocketing wholesale energy prices. However, I strongly encourage FERC to improve on this market mitigation plan by expanding it to the entire Western region at all times of the day. Such an order should include a must-sell provision similar to the must-sell mandate in the April 24th order. Also, to prevent megawatt laundering, electricity marketers need to be included in the market mitigation plan and prevented from selling at rates above the market clearing price.

Outages at generating plants have proven to be a major problem in California, helping to drive up prices to astronomical levels. Outages in California are currently averaging close to 12,000 MW on a daily basis. Historically, outages account for only 3,000-4,000 MW at this time of year. I recognize the unusual circumstances, in which old plants operated overtime to provide power to California last summer and this winter that have contributed to higher than normal outage rates. However, I also recognize that the withholding of power is a simple way for generators to drastically increase electricity prices on the spot market. FERC may not have the resources to investigate every outage in order to prevent withholdings. Please report to Congress on ways in which the Federal government can insure that withholdings and poorly-timed outages do not occur in the future.

I intend to introduce legislation shortly that will do the following:

- direct FERC to expand its market mitigation plan to the Western System Coordinating Council territory in the United States
- direct the mitigation plan to be in effect 24 hours a day, 7 days a week for the real time market (24 hours or less)
- prevent megawatt laundering
- repeal the 60-day delay in FERC's ability to consider refunds when it finds unjust and unreasonable prices
- penalize generators, that charge unjust and unreasonable rates, by giving FERC new authority to assess penalties above the exact amount of overcharge
- require FERC to report to Congress on how to improve FERC's oversight to investigate and coordinate power plant outages
- provide the Secretary of Energy with the authority to revoke the market mitigation plan if the plan results in decreased supply or increased demand for electricity
- sunset the market mitigation plan on September 30, 2002.

The purpose of my legislation is to provide a cooling off period until new supplies are on-line and long-term solutions can be implemented. The legislation is a compromise proposal that will ensure just and reasonable rates, discourage price gouging, and encourage investments in efficient, low cost power generation. The majority of my proposals can be initiated by FERC without new legislation. Therefore, I urge FERC to implement these ideas as soon as possible to provide immediate relief to the Western market.

If you have any questions about this request, please call Subcommittee Staff Director Dan Skopec on (202) 225-4407. Thank you for your attention to this request.

Sincerely,

Doug Ose
Chairman
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs

cc: The Honorable Dan Burton
The Honorable John Tierney
California Congressional Delegation

ONE HUNDRED SEVENTH CONGRESS

Congress of the United States

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www.house.gov/reform

May 4, 2001

The Honorable Gray Davis
Governor
Office of the Governor
State Capitol Building
Sacramento, CA 95814

Dear Governor Davis:

In late April 2001, the House Government Reform Committee and its Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs held three field hearings in California on the electricity crisis. The Committee reviewed several aspects of the crisis, including forecasts for blackouts this summer. This letter requests information about the expected 5,000 megawatts (MW) shortfall of electricity capacity this summer in California.

According to the California Energy Commission (CEC), the State of California will be 5,000 MW short during peak summer hours. However, after a close examination of the contracts that the California Department of Water Resources (DWR) signed for power, I am concerned that this estimate appears to be inaccurate. As a consequence, I would like to know both the background supporting this 5,000 MW estimate and the likely capacity available this summer.

Information obtained on the CEC website outlines the resources, anticipated shortfalls, and proposed resources to meet the shortfalls. The website shows an estimated 45,025 MW under the existing Independent System Operator (ISO) Control Area Resources. Is this guaranteed capacity? In other words, does California have firm contracts and guarantees to acquire these 45 gigawatts (GW) of power? Which entities will be providing these 45 GW and what prices will be paid for this electricity? Are the qualifying facilities that are off-line included in the 45 GW estimate?

Additionally, I understand that there are an estimated 4,834 MW of net imports, including some from the Pacific Northwest. Is the capacity of these imports under contract and what prices will be paid for this electricity? Will this imported capacity be available as electricity to California? Does this estimate take into account the reduced hydropower output in the Pacific Northwest, including from the Bonneville Power Administration?

Is the capacity listed from the Los Angeles Department of Water and Power (LADWP) Control Area Resources guaranteed capacity? If LADWP has excess capacity, are there guaranteed contracts or agreements for that capacity to provide the excess power to other parts of California? Similarly, is the capacity from the Imperial Irrigation District and the Far North–Eastern Sierras service area guaranteed generation capacity that will be providing electricity to California this summer?

The CEC appears to assume that outages on a monthly basis will be approximately 3,050 MW. However, on May 4, 2001, the outages were running 15,000 MW. Are these higher outages taken into account for the power generation DWR expects to acquire? If not, is there some reason to believe that outages will be dramatically reduced in the near future?

On a related issue, please provide the peak projected electricity demand for each month assuming it is a 1 in 2, 1 in 5, 1 in 10, or 1 in 40 hot weather year. Corresponding to the peak projected demands, please provide the guaranteed electricity available for each month remaining in 2001.

In reviewing the contracts the DWR entered into, there appear to be discrepancies between the capacities in the contracts and those reported by the CEC as capacity available to California this summer. Please provide the details of the power capacity available and the plans to meet the shortfall.

Please provide the information requested in this letter to the majority staff in B-377 Rayburn House Building and the minority staff in B-350A Rayburn House Office Building not later than May 11, 2001. If you have any questions about this request, please call Subcommittee Staff Director Dan Skopec on (202) 225-4407. Thank you for your attention to this request.

Sincerely,

Doug Ose
Chairman
Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs

cc: The Honorable Dan Burton
The Honorable John Tierney

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www.house.gov/reform

May 7, 2001

Chairman William J. Keese
Commissioner,
California Energy Commission
1516 Ninth Street, MS-32
Sacramento, CA 95814

Dear Chairman Keese:

In late April 2001, the House Government Reform Committee and its Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs held three field hearings in California on the electricity crisis. The Committee reviewed several aspects of the crisis, including forecasts for blackouts this summer. This letter requests information about the expected 5,000 megawatts (MW) shortfall of electricity capacity this summer in California.

According to the California Energy Commission (CEC), the State of California will be 5,000 MW short during peak summer hours. However, after a close examination of the contracts that the California Department of Water Resources (DWR) signed for power, I am concerned that this estimate appears to be inaccurate. As a consequence, I would like to know both the background supporting this 5,000 MW estimate and the likely capacity available this summer.

Information obtained on the CEC website outlines the resources, anticipated shortfalls, and proposed resources to meet the shortfalls. The website shows an estimated 45,025 MW under the existing Independent System Operator (ISO) Control Area Resources. Is this guaranteed capacity? In other words, does California have firm contracts and guarantees to acquire these 45 gigawatts (GW) of power? Which entities will be providing these 45 GW and what prices will be paid for this electricity? Are the qualifying facilities that are off-line included in the 45 GW estimate?

Additionally, the CEC claims that there are an estimated 4,834 MW of net imports from the Pacific Northwest. Who are these net importers? Is the capacity of these imports under contract and what prices will be paid for this electricity? Will this imported capacity be available as electricity to California? Does this estimate take into account the reduced hydropower output in the Pacific Northwest, including from the Bonneville Power Administration?

Is the capacity listed from the Los Angeles Department of Water and Power (LADWP) Control Area Resources guaranteed capacity? If LADWP has excess capacity, are there guaranteed contracts or agreements for that capacity to provide the excess power to other parts of California? Similarly, is the capacity from the Imperial Irrigation District and the Far North–Eastern Sierras service area guaranteed generation capacity that will be providing electricity to California this summer?

The CEC appears to assume that outages on a monthly basis will be approximately 3,050 MW. However, on May 4, 2001, the outages were running 15,000 MW. Are these higher outages taken into account for the power generation DWR expects to acquire? If not, is there some reason to believe that outages will be dramatically reduced in the near future?

On a related issue, please provide the peak projected electricity demand for each month assuming it is a 1 in 2, 1 in 5, 1 in 10, or 1 in 40 hot weather year. Corresponding to the peak projected demands, please provide the guaranteed electricity available for each month remaining in 2001.

In reviewing the contracts the DWR entered into, there appear to be discrepancies between the capacities in the contracts and those reported by the CEC as capacity available to California this summer. Please provide the details of the power capacity available and the plans to meet the shortfall.

Please release the information requested in this letter and it to the majority staff in B-377 Rayburn House Building and the minority staff in B-350A Rayburn House Office Building not later than May 14, 2001. If you have any questions about this request, please call Subcommittee Staff Director Dan Skopec on (202) 225-4407. Thank you for your attention to this request.

Sincerely,

Doug Ose
Chairman
Subcommittee on Energy Policy, Natural
Resources and Regulatory Affairs

cc: The Honorable Dan Burton
The Honorable John Tierney